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Hon C. R. McTague

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ROYAL COMMISSION ON TRANSPORTATION

Proceedings of hearings held in the Court Room, Board of Transport Commissioners Offices, Ottawa, Ontario, on the 6th day of June, 1960.

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Page	Line	Reads	Should read
13462	12	68 lbs.	68,000 lbs.
13468	7	railway and shops	railway and ships
13474	16	cost mechanism	price mechanism
13487	11	is	needs
13526	9	burden	contribution

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13584	25	traders	truckers
13593	25	take	keep
13613	3	acres	cars
13619	13	Manitoba	Emerson, Manitoba
13635	6	Mr. Creery	Mr. Currie
13640	9	Except for	Only
13661	18	not for shippers	delete "not"

have given us something very controversial and very interesting, and we are sure we are going to have a very interesting week.

THE WITNESS: Thank you.

THE CHAIRMAN: And you will, too. Mr. Brazier?

MR. BRAZIER: Mr. Chairman, members of the Commission, before we go to the second part of the brief, there are certain corrections that should be made in respect of Part I, and if I may point those out to the Commission. It seems it does not matter how many times you go through a brief you find slight errors still remaining in it.

DIRECT EXAMINATION BY MR. BRAZIER:

Q. Now, at page 25 of our original brief, which is reported in Volume 41, page 6921, there is an amendment to be made. I wonder if you, Mr. Hughes, would give to the Commission the change that has to be made in table 14.

A. Table 14, the water-long tons incoming should be 72,359 instead of 760, and outgoing 69,790. The source at the bottom has been changed. Under the subheading 1, traffic to and from east and west coasts, etc., should be DBS Shipping Report. Instead of the footnote 1 on the bottom of the table it should be DBS Shipping Report, 1958.

MR. McDONALD: Could you give us those figures again?

THE WITNESS: Incoming for water, 72,359; outgoing, 69,790.

MR. BRAZIER: Q. Now, the next one, Mr Hughes, is on page 33 of the brief, page 6927 of the transcript. I think there has been a change in respect to the bridge subsidy and coal to Ontario since the brief was written?

A. I don't know the Board Order number -- Board Order 861 put coal to Ontario under the bridge subsidy since June 1st, 1960 -- just a note on page 33.

MR. BRAZIER: It is just recently issued by the Board itself.

Q. The next amendment we have is to table 19 on page 36 of the brief, which is reported at

page 6930 of the transcript?

A. Table 19 just shows that I can't do aritnmetic very well, and in column 4 the total should be 388 instead of 288.

COMMISSIONER ANSCOMB: Just an error in addition; that is sll.

THE WITNESS: Yes; and straight underneath that, total British Columbia and Ontario, 629 instead of 529, and British Columbia as percentage of total, 38.4 instead of 45.5.

MR. BRAZIER: Q. Now at page 40 of the brief, Mr. Hughes, reported at page 6932 of the transcript, page 40 of the brief in the second column, the last paragraph, I think there is an amendment?

A. The paragraph starts -- I will read the correct paragraph:

> "The deficit arising out of commuter services undoubtedly accounts for a substantial part of passenger losses. Mr. Gordon, commenting on the fact that commuters represented 37.4 per cent of all passengers carried but contributed only 3 per cent of passenger revenues . . ."

It is 3 per cent instead of 30 per cent.

Q. Are there any other changes you think should be made as far as Part I is concerned?

A. No, thatis all, Mr. Brazier.

MR. BRAZIER: Mr. Chairman and gentlemen of the Commission, before we go to Part 2 I should like to

say that Part 2 is presented by the Government of British Columbia in what it is hoped will be a valuable contribution to the study which your Commission must necessarily make in order to prepare a report that might offer the necessary solution to a very long-standing subject of complaint and difficulty in Canada.

THE CHAIRMAN: It is a very valuable contribution and represents a great deal of work by Mr.Hughes. We know that.

MR. BRAZIER: There is no doubt about it, Mr. Chairman. We do not put it in a dogmatic fashion in any way; we offer it to the Commission for their consideration and study. It may be that the Commission, on the advice of its experts, may see fit to adopt parts of it and not adopt other parts.

THE CHAIRMAN: Well, we will look at it very carefully, and we think that Mr. Hughes and Mr. Guest have done a great job on this.

MR. BRAZIER: Yes, I am quite sure of it.

I would also commend -- because before this Commission I think there have been some other parties who have talked somewhat about the cost of service principle in the present Commissio -- I would commend to the attention of the Commission that the Province of British Columbia did make such a proposal before the Turgeon Commission.

THE CHAIRMAN: Ten years ago.

MR. BRAZIER: Some ten or eleven years ago. I commend to the Commission the report of that Commission

starting on page 118 of their report where they, you might say, summarily dismissed the thought that this should be adopted in Canada. I might say, too, for the information of the Commission that some several years later, when Mr. Justice Turgeon returned to Canada to preside on the Royal Commission on Agreed Charges, I did have very lengthy discussion with him on this matter, and at that time he advised me that from his further studies of cost of service principle it did seem that he had dealt with it too summarily in the original report, but he had given it further thought.

MR. SINCLAIR: We, of course, had cross-examination ---

MR. BRAZIER: I am not suggesting he was ever then going to report it, but in the meantime he found that it had more merit that probably he had originally thought.

THE CHAIRMAN: We realize Mr. Brazier is not giving evidence.

MR. BRAZIER: In presenting the brief as Mr. Hughes has done on behalf of the Government, he is really here to explain and possibly expand on the brief as it is prepared. I appreciate some of my learned friends would like to get an expression of opinion in so far as the Government of British Columbia is concerned on other issues, issues which are not set forth in this brief, and I can assure the Commission that in due course, either on his or on behalf of the Government, we will give you the benefit of our opinion on all

controversial subjects that are before the Commission. But I do hope my learned friends will not attempt to get Mr. Hughes to express views on behalf of the Government on things which are not in the brief, because he is in the very difficult position that unless they are in the brief they have not been approved by the necessary ministers of the Crown in the Province of British Columbia.

With those comments, I offer to the Commission Part II of our brief, and in this, as it is now presented to the Commission, there are two small amendments which we wish to make.

Q. First, on page 29 in respect to the tables indicated there, would you, Mr. Hughes, now advise the Commission what amendments you wish to make in respect to the tables set forth on page 29?

A. Yes. First I better say a word about why I am making the amendment. On discussion of this table and on thinking about it I realized, of course -- and I should have realized before -- that the terminal costs do not vary so much with the 100 pounds but they do vary, of course, with the number of cars going through a terminal. So as I have it there now, it would have penalized the man sending a good carload through, he would pay so much more per 100 pounds; whereas the man sending a fully loaded car through a terminal should pay about the same for switching the car, so I realized an alteration should be made here. So the total -- and there is another mistake made, too.

Going down from the distance factor at the top of the table on page 29 and reading under "Cents per 100 pounds," the distance in miles, 100-199, reading along the column as it is, 20, 18, 16, 14, 12 -- that column is all right. The second one, 200-299, should be 21, 19, 17, 15 and 13.

In the arbitraries, the terminal group arbitrary, reading along A, B, C, D, we get "dollars per carload".

Q. That is, instead of "cents per hundred lbs." you substitute "dollars per carload"; is that correct?

A. That is right. Then under A, we have $40; under B, $50; under C, $60; under D, $70.

MR. HUME: Is it dollars per carload?

THE WITNESS: Dollars per carload.

MR. McDONALD: Under "Terminal Group"?

MR. BRAZIER: Yes.

THE CHAIRMAN: And the route group ---

A. Route group remains the same.

THE CHAIRMAN: Remains the same.

MR. BRAZIER: Q. How does that change the minimum rate as set forth in paragraph 104?

A. Paragraph 104 now reads:

"A minimum rate would be found by addition.
"For example, a minimum rate for 50,000 lbs.
"of Article X shipped 100 miles through two
"Group A terminals over Route B:

" Rating	70
" Distance rate	16¢
" Route arbitrary	2¢
"Total rate per 100 lbs.	18¢

"Plus terminal arbitrary (x2) $80 per carload.
"Total minimum charge for carload of
"50,000 lbs., $170."

Q. Now, on page 35, the footnote that you

[illegible]

have there I think needs to be amended.

A. Page 35, footnote, G. Lloyd Wilson -- there is no source cited there. The source I have given is wrong. Unfortunately I have left the little book in British Columbia, but I can give you the approximate title and then let you know at some later time when I get the book, tell you what it is. The book is by the Railway Progress Institute to the best of my recollection, and this is a prize essay and I believe it is called "Do We Need New Railroad Freight Structure?" or something to that effect. It is a little pamphlet. I can let you know the full title when I get back.

[illegible]

CHAPTER 6

Rate-Making Concepts

1. The purpose of Part 2 of this submission is to recommend to the Royal Commission a railway rate-making proposal, the adoption of which, it is believed, will help alleviate many of the current problems of the railways and shippers. To this end, methods of railway rate-making will be examined.

2. There are three basic methods of rate-making which, though not mutually exclusive, have distinctive characteristics. The methods are setting rates according to

(a) value of commodity;

(b) value of service;

(c) what the traffic will bear.

Value of Commodity

3. This method of rate-making is the one used in the Canadian Freight Classification and the related class rate tariffs. The value of the article consigned is the important consideration in setting a class rate for a commodity, (W. T. Jackman, Principles of Transportation; Toronto: The University of Toronto Press, 1935, p. 326) though other factors are also taken into account, such as bulk, risk of damage, and, of course, weight and distance. The foundation stone of the freight-rate structure is the classification (Ibid., p. 155) because, although only a very small percentage of traffic is carried at class rates, many

commodity rates are fixed as a percentage of them. ("The carriers made no serious objection to the proposal to abolish the standard mileage class rates. They did state, however, that these rates are the 'key' on which other rates are based and that they are necessary to preserve flexibility in the rate structure." Report of the Royal Commission on Transportation, Ottawa, 1951, p. 83.)

4. Rates based primarily according to the value of the commodities handled depend on the existence of a monopoly in the railway business. That monopoly has completely disappeared for a large volume of traffic (but not all) is evident and needs no elaboration beyond the statement in the Lessard Report:

> "Competition, therefore, has risen from a position of comparative insignificance to a major consideration in the structure of the transportation industry. Railway monopoly, based on technological conditions, has been virtually ended over an ever-widening area in transportation for as far as it is possible to see into the future. Indeed competition is likely to become much more intense over the next quarter of a century."

(Royal Commission on Canada's Economic Prospects, J. C. Lessard, "Transportation in Canada." Ottawa: 1956, p. 75.)

5. One result of the breakdown of much of the railway monopoly is that the effectiveness of class and class-related rates is completely undermined.

Such a rate structure is failing to provide the necessary revenue and traffic to support healthy railways, with dire consequences for the traffic which is still captive. A great deal of traffic is being diverted to motor carriers, both for-hire and private. Such carriers do not necessarily handle the high-valued commodities at a lower cost than the railways, but the movements are cheaper to the shippers than the railway rates. Because motor carriers help themselves to the cream of the traffic, they are able to accept low rates on back hauls of basic traffic which would normally be beyond their reach. Thus the railways lose both high-valued traffic and also basic commodity traffic by the truck return movements. Commissioner Turgeon notes:

> "So long as the railways had a monopoly of inland transportation the broad basis of the rate structure was reasonably satisfactory. But during the past twenty years the railways have lost their monopoly position. No longer can they obtain increased revenues from the high-value commodities as an offset to the lesser revenues obtained from the low-value commodities, because a substantial [illegible] of the high-value commodities are now moved, or have the option of being moved, by highway transport. Thus that part of the traffic wherein the high-value commodities lie has ceased to be a monopoly and

has become intensively competitive; but the railways are required to charge for their services within a regulatory framework which restricts their ability to meet the competition effectively."

(Report of Royal Commission on Agreed Charges. Ottawa: 1955, p. 20.

6. It is the view of this submission that the value of commodity basis of rate-making is completely outmoded, a view which is presumably shared by Mr. L. J. Knowles, Commissioner of the Board of Transport Commissioners, in the following passage from his evidence to the Senate Standing Committee on Transport and Communications:

"Senator Smith (Queens-Shelburne): Of course, that factor you speak about is almost historical of railroads. But is there any important reason why that very basis for moving steel could not be changed? Does it cost the railway companies any more to move semi-manufactured steel that is carried a little farther in the original raw state per ton and per car? Is there any real reason why it oould not be changed?

"Mr. Knowles: No, not on a cost basis, except in the case of a heavily-loaded car the unit cost would be somewhat less than it would be on a lightly-loaded car. But, Senator Smith, you have asked a great fundamental

question in ratemaking that is worrying everybody today, and that is, the way the rate structure is made now, high rates are charged on high-grade materials and low rates on low-grade materials,and the higher rates are being eroded by the trucks and railways are being left the low-grade articles which are moved at a rate less than the average cost of transportation. That is the great problem all over the world today, I read it in all the railway magazines -- that is, the fact that the original method of ratemaking on a value basis, while it was very good for seventy-five years, is out of date today, and it may be that the railways will have to come to a more cost basis of fixing rates."

(Proceedings of the Standing Committee on Transport and Communications on Bill C-38. Senate of Canada, 2nd Session, 24th Parliament, June 1959, pp. 13,14.)

7. The erosion of railway traffic in the higher classes means that there is not the same opportunity to practise differential pricing as there used to be. The railways can no longer rely on these rates to cover most of the system overheads. Moreover, these rates can only be increased at the risk of losing even more high-valued traffic to competitors. It is largely for this reason that a greater and greater proportion of any increased revenue requirements has to be recovered from the

remaining captive traffic.

8. The system of basing rates on the artificial basis of commodity value has outlived its usefulness, however, convenient it may be. Although a class rate structure (which includes related commodity rates) still has advocates, such a system is not possible where competition exists. The greatest competition which the railways have to face is from trucks, many of which are privately owned, and many others are not subject to rate or entry control. To meet such competition it is essential that rates do not diverge too greatly from costs, whereas many present rates are an umbrella under which lower rated but higher cost competition can shelter.

9. One other effect of value of commodity pricing is that a mislocation of industry is encouraged. Industry, other things being equal, will tend to locate where aggregate prices are the lowest. Economic efficiency in the use of resources dictates that industry should locate where the aggregate economic costs are the least, hence, if transport prices diverge from transport costs of service -- as under the class rate system -- mislocation of industry is encouraged.

10. The shortcomings of a rate system based on value of commodities are many in this age of transportation competition. The breakdown of railway monopoly, the siphoning-off of remunerative high-grade traffic by competition, and the possible mislocation of economic activity are in themselves sufficient reason

for the abandonment of the Canadian Freight Classification and such rates as are related to class rates. Recognition should be given to changing economic conditions, and it is suggested that a pricing system more nearly related to the cost of providing service be adopted.

Value of Service

11. This method of rate making is based on the value of transportation service to the shipper and involves a different principle from value of commodity pricing. The term "value of service" is self-explanatory. No shipper will pay a higher freight rate than the service is worth to him. To charge on a basis of value of service, therefore, is to charge rates that the shippers are willing to pay. Where the railway has monopoly, a high price can be exacted, but where there is competition, only a low price can be asked. Value of service to the shipper is determined by the availability of substitute services and by the amount of competition that the shipper himself has to meet in marketing his produce. The greater the competition, either carrier or market competition, the less is the value of service. Moreover, the value of service, being a subjective concept, is different to every person whose goods are transported. A railway charging rates on such a basis would quote a different price to each sustomer.

12. Value of service is often taken to be the difference between the price of the commodity at the place of production and the price at the selling point,

the "value added" due to transportation being the value of service. This point of view has weaknesses, however, as the difference in price between the two points could just as well be due to market forces. If there is little competition at the selling point, the difference in price may be much more than the cost of transportation.

13. Rates based on the value of service alone can be criticized first, because they are obviously not related to the cost of providing such service. They are, therefore, suspect for the same reason as class rates in that they tend to mislocate economic activity. Another criticism of the value of service principle is that as it is not related to costs there is no guarantee that they will be recouped. If rates are reduced below out-of-pocket costs, for example, some other traffic has to make up the loss. This has a twofold effect. Prospective competitors of the railway are deprived of traffic which they may be able to move at compensatory rates. The burden of high rates on other shippers prevents them from fully exploiting their markets. Such shippers may turn to trucks if rates lower than rail charges were offered, even though the real transportation costs may be higher.

14. Some economists would go so far as to say that value of service in rate making was not desirable. For example:

> "Although the proponents of such a policy never put their case explicitly, it is generally argued that value-of-service rate

making is desirable for the entire economy and a necessity for the financial stability of transportation industries. The preponderance of the evidence, however, would appear to point to exactly a contrary conclusion: namely, that value of service rate making as now practised is both undesirable and unnecessary."

(John R. Meyer et al., The Economics of Competition in the Transportation Industries. Cambridge: Harvard University Press, 1959, p. 181.)

15. Value of service pricing is, of course, discriminatory, in that differences in rates between various commodities and shippers are not based on differences in costs. This kind of discrimination, being legal providing that it is not 'unjust,' is not the subject of complaint before regulatory bodies. Nevertheless, general complaints of such discrimination must be more widespread than if a cost of service principle were employed, where it would be shown that rate differences were fully justified on the grounds of differences in costs. Though this is a small point, its importance should not be overlooked. Should a cost of service principle be adopted, charges of "undue preference" and "unjust discrimination" would become almost passe as "justice" in the matter of transport rates then becomes a matter of justice in terms of relative costs.

16. A closely related criticism of value of service rate making is that it may result in rates

which are extortionate in the absence of competition. Though competition is an automatic regulator of rates, the platitude that competition now pervades the transportation industries is no consolation to the "captive" shippers. Where competition has not pierced the rate structure, value of service rates can be very high in relation to costs. If other rates are below costs for good reasons, it is difficult for regulators to outlaw the extortionate rates which may be called upon to bear othewise unjustifiable increases. (For example, in the 17 per cent case it was contended by the Provinces that the traffic producing approximately 35 per cent of the total revenue of Canadian National and Canadian Pacific was expected to assume approximately 73 per cent of the revenue increases from increased rates. 48 J.O.R.R. 16A, p. 16.)

What the Traffic Will Bear

17. The third principle of rate making, what the traffic will bear, is well described by Locklin: (P. Philip Locklin, Economics of Transportation. Homewood: Richard D. Irwin, Inc., 4th ed., 1954, pp. 155,156.)

"The railroad rarely attempts to charge the entire value of the service on each commodity or class of traffic. The value of the service sets the upper limit beyond which the traffic will not move. Prime or variable costs, on the other hand, fix the lower limit

below which the rate must not fall. But where, between the upper and lower limits, will the rate be fixed? The answer is summed up in the phrase 'charging what the traffic will bear.' This is a much-abused phrase. It is often falsely interpreted to mean exacting the highest possible charge that can be extorted from shippers. The policy is more accurately, but more cumbersomely, expressed as 'not charging what the traffic will not bear.' The practice is one of granting concessions to traffic that will not move at normal rates, although this may, if not controlled in the public interest, lead to higher rates than are necessary on traffic that will stand high rates. To be more precise, charging what the traffic will bear means charging the rate on each commodity which, when the volume of traffic is considered, will make the largest total contribution to fixed or overhead expenses."

18. Such an interpretation of "what the traffic will bear" means in its pure form that the railway will attempt to limit its output of service to the point where the additional revenue gained from the last unit of traffic is equal to the additional cost incurred. It will do this because if output were less than this, net receipts would not be maximized, while if output were greater than this, additional costs would exceed additional revenue. The railway, having limited out-

put at this "optimum" point, will charge the highest price possible consistent with the output; in other words, the price determined by the value of the service. (This is simply to equate marginal cost and marginal revenue by limiting output. See Joan Robinson, The Economics of Imperfect Competition. London: Macmillan & Co. Ltd., 1954, pp. 51,52.) As the value of service is different for each customer, or class of customer, this leads to differential charging; i.e., charging different prices to an extent not justified by differences in cost. However, the principles of charging what the traffic will bear and charging according to the value of service must be distinguished. There is nothing in the latter principle to prevent rates from going below cost, while in the former case the railway would not sell any output where additional revenue was less than the additional cost incurred. Any railway which still retained monopoly powers and which had no fear of prospective competition would, in the absence of control, make monopoly profits. Regulation attempts to siphon away these monopoly profits by rate-control and by the obligation to provide service. Even so, many rates are not the subject of complaint when they have been set and the provision of service is no longer a prime issue. There is, in fact, little to prevent the full working of the principle of charging what the traffic will bear on all but class and equalized commodity rates today.

19. Charging what the traffic will bear is simply a refinement of the value of service principle, and as such is open to many of the same objections. The objective of this type of rate making is the maximization of net receipts; therefore, no service can be sold at less than cost. As has been pointed out, the maximization of net receipts involves the restriction of output to the point where the additional costs incurred equal the additional revenue. The process presumably is carried out by railway companies in charging rates on the majority of traffic not bearing equalized or statutory rates. It is a selective process, having regard to particular commodities and the extent of competition on particular routes. This results in the accrual of monopoly profits where demand for transportation is less thanperfectly elastic. However, objections to certain rates may be made by shippers or competitors on various grounds in which case rates may be fixed by the Board of Transport Commissioners so as to deny monopoly profits to the railway on certain services. The railway services as a whole do not, of course, earn any net revenue which can be construed as monopoly profits over traffic in total because of the effect of statutory rates and the provision of some transportation (e.g., passenger traffic) at value of service rates which are less than cost.

20. The criticism of a charging system based on what the traffic will bear resolves itself into an argument against monopoly discriminatory pricing

practice in general, where prices are above the cost of service in varying degress. Such pricing, not based on the costs of service, has the tendency of mislocating economic activity. Extortionate rates may be charged in the absence of competition, and so the burden of overheads is borne by a smaller and smaller segment of traffic with every rate increase. However, if the worst abuses can be overcome by exercise of the powers of the Board of Transport Commissioners to order the provision of service beyond a monopoly output where necessary and by maximum rate-control for captive traffic, "what the traffic will bear" rate making has many desirable features. Such a pricing system is beneficial to the railways in that it maximizes net receipts on individual traffics and the average cost of transportation is reduced through expansion of total railway output when the railway enjoys decreasing costs.

21. The case for differential charging which will bring about lower rates for high-rated traffic and also which enables low-valued traffic to move rests on the railway having a large amount of fixed costs. As the units of traffic transported increase, so the average unit costs decrease as the fixed costs are spread over the greater output. Because railways are said to have a large proportion of fixed costs, they are also said to be a decreasing-cost industry. If this is so, they can differentially price their output so as to maximize revenues up to the limits of operating capacity. So long as rates cover at least the additional cost of

hauling the traffic; differential charging enables more traffic to be obtained. The large amount of traffic enables a greater sharing out of the fixed costs and a consequent reduction in average total costs per unit of traffic. The system encourages full utilization of railway facilities and makes for the best possible recovery of overheads. The advantages of such rate making, and the need for certain safeguards, are recognized by Professor Harbeson. (R. W. Harbeson, Transport and Communications Review, "Cost Finding in Rail Transportation: Some Lessons from American Experience." Oct.-Dec., 1953).

"The objective of this type of pricing is to spread the constant costs over a volume of traffic such as will achieve full utilization of a railway plant of optimum size and thereby to attain the lowest possible total unit cost for transportation service. This type of rate making is socially desirable provided it is safeguarded in three ways:

"(1) Rates on particular commodities and particular hauls must at least cover the additional cost which they occasion;

"(2) There should be no exploitation of particular traffic simply because it can stand high rates. Rates on high-rated traffic should not be greater than they would be if the low-rated traffic did not move; in

other words, discrimination should be downward, not upward;

"(3) The total earnings of the railroad from its entire volume of traffic should be limited to a competitive rate of return on its investment."

Breakdown of Railway Monopoly

22. The methods of rate making described, according to commodity value, value of service, and what the traffic will bear, to be effective, depend on some degree of railway monopoly. The breakdown of this monopoly for much traffic, and hence many of the difficulties in which railways find themselves, can be attributed to many causes. In this respect Lessard (Lessard, op. cit., pp 77-84) notes that the Canadian economy has in recent years undergone a radical change, from being an agricultural economy to one that is now highly industrialized. This gives rise to motor-trucking, especially in the private carriage field, as this form of transport fulfils the needs of secondary industry where speed and service are paramount considerations. The same factors encouraged the growth of air freight, while pipe lines are a natural outcome of the large discoveries of oil in the west dating from 1947. The St. Lawrence Seaway will continue the trend of breaking up the rail monopoly, at least in central Canada. Mr. N. R. Crump estimated the effects of Seaway competition on the Canadian Pacific Railway traffic in the following words:

> "Even under the toll system our Traffic Officers estimate that approximately two million tons of your railway's freight, having a revenue value in excess of $38 million annually, will be exposed to seaway competition. It is to be hoped that over the long term, industrial development along the seaway may offset in some measure this more immediate adverse effect."

(Canadian Pacific Railway Company, 78th Annual General Meeting of Shareholders, Report of Proceedings, May 6th, 1959, Montreal, p. 6.)

23. Outdated regulation which was designed for a monopoly regime rather than for competitive conditions can also be blamed for some loss of traffic. A particular regulation which is non sequitur today because of the tremendous growth of competition is the one and one-third rule. There can be no dispute with Lessard when he says:

> "Regulation is more restrictive for railways than for other carriers and, more important, is becoming more onerous with the growth of competition."

(Lessard, op. cit., p. 88.)

24. The report "Transportation in Canada" mentions that it has proved more difficult for railways to abandon service vis-a-vis other carriers: (Ibid., p. 91) and "railway rates must be filed, published and strictly

adhered to, and be the same for all shippers." (Ibid, p. 94. And the same point of outdated regulation is made in the report of the Royal Commission on Agreed Charges:

"I do not submit the foregoing as a detailed explanation of the 'railway problem,' but only as an indication of certain features of the freight rate structure which are basic to the matters before me. I think it evident that it must be borne in mind that, as appears from the foregoing, the railways have been compelled to operate most of the time under comprehensive regulation which as designed originally for conditions specifically different from those existing today. Basically, it was the regulation of monopoly in the public interest. With the exception of water transportation, where such existed, the shipper had no other carrier to which he could turn for service. As such, the regulation recognized only such competition as would occur between different rail carriers and between rail and water carriers. It did not recognize a situation wherein the railways would be faced with active and intense competition for a particular part of its traffic, the high rated traffic. Today the railways operate under two different sets of conditions: one, where they still have a monopoly and present regulation remains suitable; the other where they are faced with intense competition, and present regulation

[illegible]

puts them in an unfair position because it binds them almost as closely as it did in the time of their monopoly." Report of Royal Commission on Agreed Charges, op. cit., p. 20.)

25. The decline of the rail monopoly has also been hastened by onerous obligations imposed for reasons of national policy. Crowsnest rates are a prime example. Some of the blame for the decline of the railway share of traffic can be laid at the door of railway management itself. There has been a tendency to cling to an outdated rate structure, and railways were admonished to change it to meet modern conditions in the Western Incentive Rates Case:

"The railways have struggled along under this handicap for the past twenty-five years, because they were naturally reluctant to make radical changes in their rate structure. This has gone on so long that the highway operators have assumed that they can refer to it as 'the established rate structure' and that complaints against changing it will have due effect. There is, however, nothing inherently sacred or static in the freight rate structure, and nothing to prevent the railways from changing it to meet modern conditions, subject to the provisions of the Railway Act. The railways can carry traffic at an average rate of 1½ cents per ton mile and there is no object in clinging to an ineffective rate structure which results in

charges on some traffic of 3 cents to 10 cents per ton mile when their competitors can handle it for less."

(48 J.O.R.R. 22, p. 532.)

26. Before the Turgeon Commission the railways said that the standard mileage class rates were the "key" rates on which other rates were based. For this they were criticized in the report for using these as key rates since such a small proportion of freight moved under them. (Report of the Royal Commission on Transportation, Ottawa, 1951, op. cit., p. 83.)

27. Whatever the causes of the breakdown of railway monopoly in some areas, the occurrence can hardly be disputed, and a new look at basic-rate making principles in the light of new conditions is needed. The infusion of competition into the transportation industries has taken away high-grade traffic from the railways, leaving them with low-valued commodities in which competitors have little interest. If the railways wished to retain high-valued traffic, they have had to quote lower competitive and other special rates, thus virtually decapitating the upper end of the rate structure. As high-valued commodities are no longer able to contribute to overheads to the same extent as before, low-valued traffic, where not competitive, has had to take the brunt of all rate increases.

28. It is the contention of this brief that rate making more closely associated with the costs of

providing services is more suited to the conditions in which railways find themselves today. The adoption of such rate making would preserve the economic health of the railways, would result in greater technical innovation, encourage capital and other resources to flow to the right quarters, and, of course, enable railways and other transportation media to obtain traffic which they could be carrying in the light of their inherent advantages. It goes without saying that such results would be to the advantage of the country as a whole, and Canadians would be getting the most out of their transportation dollars.

29. In view of the growth of competition, one would expect that there would have been a corresponding move toward rate making based on costs in order that the full potentialities of railway cost advantages could be realized. However, this has not been the case. Railway management seems to have been somewhat complacent about the competitive situation up to now in view of increasing railway tonnage induced by rising industrial production, population, and gross national product in the last decade. The fact that the rail share of tonnage has declined is obscured in a growing economy, and the relative loss of traffic has been cushioned by absolute gains. Under such circumstances there has been no hurry to change long-established traditional thinking and practices.

30. The U.S. Department of Commerce notes complacency on the part of American railroads:

"But so far as appears, much loss in the freight traffic is not the result of regulatory requirement but of a failure of the carriers to come forward with appropriate proposals for adjustment. Worse, they show a tendency to expand the area of unprofitable rates and activity to solicit business that can only be handled at a loss. The public is entitled to expect that rail carriers will face their problem upon a far broader and more energetic basis than hitherto. It is entitled to expect that they should be relieved of traffic which they cannot handle on as favourable terms as other carriers, as well as that they will actively put their best foot forward in those areas where they have an economic advantage."

(Federal Transportation Policy and Program, U.S. Department of Commerce, March, 1960, p. 11.)

31 The judgment of the Western Incentive Rates Case previously cited called attention to the reluctance of the railways to change the present state of affairs, and to the false presumption of an established rate structure. At the same time the country was reminded that there was nothing sacred or static about it and nothing to prevent a change. (48 J.O.R.... 22, op. cit., p. 532.) In this regard Professor Sargent says:

"There will always be pressures from one

direction or another to divorce prices from costs. These pressures range all the way from sophisticated arguments about the difficulties of costing individual operations in an industry as complex as transport to barely disguised pleas for special terms for special men."

(J. R. Sargent, British Transport Policy. Oxford: The Clarendon Press, 1958, pp. 15, 16.)

32. The equalization of class and mileage commodity rates is another factor which makes the discarding of the old rate structure difficult. Rates originally given to meet special circumstances of particular regions have been extended to all equally, whether competition was present or not, and whether or not costs justified such rates.

33. The natural changeover to cost of service rate making is also retarded by statutory obligations to carry export grain traffic at rates which are probably below variable costs. Historically, the railways themselves assumed responsibility to carry some traffic at unremunerative rates, such as under the "At. and East grain rates." (Submission of Canadian Pacific Railway Company to the Royal Commission on Transportation. Montreal, 1949, Part I, pp. 77,78.) The railways are sometimes urged to carry other traffic which is not compensatory, such as Alberta coal to Ontario points. (Ibid., p. 96.) There is a moral obligation assumed to carry passenger traffic, much of which does not earn its costs; there are mandatory

obligations to continue the working of remunerative lines even where their profitability is doubtful and where reasonable alternative transportation does not exist. One of the most potent reasons for clinging to the old structure, however, is the understandable difficulty of cost-finding on the part of railway management and a great deal of traffic may be unwittingly carried at a loss.

34. Notwithstanding vested interests, difficulties, statutory and moral obligations, and lack of managerial initiative, the railways will have to pay greater attention to the developing of rational rate structures in tune with the encroachment of competition. In this regard Professor G. Lloyd Wilson says:

> "It is unnecessary to elaborate further by citing other evidences of the obsolescence of railroad freight rates under present-day conditions. The years of experience which have added alluvium to build up what are now known as railroad rate structures have developed a rich rate soil which supplies the fertile fields from which grow the wonderful and sometimes weird flowers of the rate structures of the railroads. They are magnificent, even if they are sometimes but vaguely understood by experts and seldom understood at all by some users of transportation services, unless the users employ competent industrial traffic managers. Is it not possible that we have

become more concerned with building up a comprehensive system of rate structures than in developing rates and practices which will actually and effectively move traffic?

. . . .

It appears obvious that the time has come for the railroads to give serious consideration to the thorough overhauling and simplification of classification rate and tariff procedure, and the construction of rates which will at the same time cover the costs of transportation and attract the traffic."

(G. Lloyd Wilson, "Are Railroad Freight Rate Structures Obsolete?" Harvard Business Review, January, 1935, pp. 184, 185.)

35. The dilatory change to pricing in keeping with times is not confined to railways, and all forms of for-hire transportation (and the nation) would undoubtedly benefit from a cost-oriented rate structure. The recent U. S. Department of Commerce report to the President said:

"Now the newer forms of common carrier transport also, still concentrating largely on competing with the rails, are generally blind in their turn to a growing competitive menace. Unregulated private and exempt carriers now haul nearly half of the intercity freight. The regulated common carriers are feeling the same competitive

weapon they used against the railroads. They still base their rates to some extent on the competitive rail rates, instead of on true cost. The unregulated carriers can skim off the most profitable traffic, that with the greatest margins between prices charged and costs. Moreover, the distinctions between what is legitimate private or exempt transportation and what is subject to regulation are difficult to draw with precision. It is even more difficult to compel compliance with such distinctions.

"Essentially the responsibility is and should be with common carriers to develop service standards and rate structures which enable them to hold their position against the possibilities for private and exempt transport and to diminish the temptation to illegitimate operations. What is needed is broad, general revision of traditional rate structures to bring them more closely into accord with cost structures. Rates should be rational based on cost studies and market facts, rather than opportunistic since sporadic and selective rate cutting can prove dangerous to the carriers and damaging to the public. Since the temptation to go this route is strong, appropriate regulatory restraint must be provided for the present. The regulatory

system must, however, become more flexible and must, indeed, encourage the adjustment which is called for. Specifically, regulatory restraint upon the upward adjustment of below-cost rates and upon the abandonment or readjustment of losing services must be very substantially removed."

(Federal Transportation Policy and Program, op. cit., p. 4.)

Effects of Cost-related Rate-making

36. The advantages of cost-oriented rate-making can best be introduced with a description of the model of competition presented by economists. In this model they see mankind acting in a rational way so that men use their economic resources in the best possible way to bring them the greatest satisfaction. When applied to business firms, this amounts to the maximization of profits by producing goods and services in the most economical way. Through competition, successful businesses outbid less successful firms for resources (labour and capital). The resources thus attracted will at first receive high returns, but competition will eventually make them no more than normal, and the returns received by the resources will be sufficient, but no more, to keep them in their employment in any particular line. Resources will then be utilized in the most profitable way, to them and to the community. There will be, in other words, economic allocation of resources, and

production of the nation's goods and service will be carried on in the most efficient way possible.

37. Through this competition for economic resources, cost of production (including normal profits, or interest payments, to capital) equals price. The prices a firm receives for the sale of its production is just sufficient to cover the costs of production. Moreover, marginal cost (the additional cost incurred in the production of an additional unit of output) equals price. If customers are willing to pay more than marginal cost for an additional unit, then it is in the public interest to let them have it, and to expand production until the last unit of output just equals the marginal cost. That marginal cost equals average cost in competition is not significant here. A competitive pricing system will have regard to marginal costs, not to average total costs, when production fluctuates. If the firm can sell an additional unit at anything above the marginal cost of producing, it then will be sold in order to maximize profit. Hence, in the economists' competitive model, price equals cost and a cost of service principle is automatically brought into effect. (This simple picture is somewhat more complicated for the transportation industries where indivisible costs are not immediately traceable to particular units of output. However, the tendency for prices to equal cost is still present.) Moreover, the principle is based on marginal costs rather

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than average total costs, and this is in the public interest.

38. The beneficial effects of relating rates to costs are many. The economic allocation of resources is the most obvious benefit from the description of the competitive model. (That other forms of pricing result in a misallocation of economic resources is recognized in the literature: "If it is accepted that optimal resource allocation is attained under either marginal or average cost pricing, the worst distortion in using present transportation needs as an approximation of optimal needs would occur when present prices diverge sharply from average or marginal costs -- that is, essentially where so-called value of service rate making is pursued." -- Meyer, op. cit., p. 145.) Through the payment of rates based on cost the community will ensure, in its self-interest, that it employs low-cost, rather than high-cost, resources. Its limited means are economized so that it is getting the most out of its transportation dollars. To make certain that the low-cost resources are employed (which may be trucks vs. railways), the community must know what the relative costs of the service are. Obviously, the existence of subsidies and value of service and value of commodity rate-making will not indicate this. If, say, highway transportation is receiving a subsidy so that its rates are less than the true cost of providing the service, the shipper,

if the service is the same, will prefer trucks to rail, even though trucking may represent the high-cost resource. If railways use a method of pricing so that rates are higher than the cost of providing the service, then a manufacturer may be induced to buy his own trucks even though they may be "uneconomic." This arises because the shippers are not interested in true costs of service but only in the rates charged. If rates are not based on costs, and there is freedom of choice, then shippers will be led in many cases to use high-cost resources. The same result obviously occurs if one transport route subsidizes another, or if freight traffic subsidizes commuters, or if the movement of one commodity subsidizes another. In order that the best use is made of transportation facilities, it is essential that the costs be borne by the particular users incurring them.

39. The pricing of transport services on a cost basis automatically ensures co-ordination of transportation. By co-ordination is meant the harmonizing of transportation operations so that each agency does the work for which it is best suited. The shipper will automatically bring about co-ordination by choosing the lowest cost form of transportation in his own self-interest.

40. The shipper is co-ordinating transport, by using the agency which is the most efficient for the particular job, only if two conditions are present together. First, the shipper must be allowed to have

free choice of the agencies he will use, otherwise he may be forced to use the one for which total production costs are higher. The shipper alone can judge which is the cheapest method of transport to use, including in his assessment all production costs including those of transportation. The second condition which must be present to ensure that the aggregate costs to the community are the least possible is that transport rates should be related to costs. If, through a subsidy, or by any method of pricing other than one which is cost orientated, price does not reflect cost, then the shipper will be led to use the "wrong" transport medium. For example, assume road ahd rail giving identical service compete on a certain route for the carriage of bricks and truck costs and rates are the lowest. Then the shipper of bricks will use the t rucks, transport co-ordination is achieved, and the most production for the least cost is the result. Suppose now that the railway company subsidizes brick traffic out of earnings on steel traffic. The shipper will transfer his allegiance to the railways in order to minimize his costs. However, as rail is the high-cost agency and prices do not reflect costs, the shipper is making a "wrong" choice. The result will be that resources will be wasted in providing expensive rail service, less transportation is being produced per dollar by patronizing the high-cost railway, and the community as a whole (but not the particular shipper) will be worse off.

41. Repercussions follow in that the railway is charging higher rates for steel than it need, and it may eventually lose the traffic to trucks.

42. Precisely the same effects occur when value of commodity pricing is used by a railway. If the value of the commodity is high, then rates will be high even though transportation costs are low. The competitor then takes the traffic even though his costs may be considerably higher than the rail costs. The railway is left with low-rated traffic and must attempt to recover overheads elsewhere. The attempt leaves the railway open to further depredations, and the problem cannot resolve itself in a competitive world unless cost of service pricing is employed. Many railway rates today are such that high-cost competitors are encouraged, while rail costs of particular traffics may actually be lower.

43. These situations are reproduced in the real world, where a great deal of economic waste is undoubtedly occurring through pricing systems which ignore the cost of service. Such pricing systems are more suited to a monopoly economy rather than to the competitive conditions today. (These points are well discussed in Sargent, op. cit., Ch. 1. Sargent's first four policy recommendations for British transport policy are:

"1. Co-ordination of transport means ensuring that wherever a transport service is required, it is provided by the method which causes the lowest

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cost in terms of the nations' real resources.

"2. In most cases this will not be sufficiently ensured by having a central transport coordinating organization decide which of the available methods shall be used, since no such organization can know or take account of the relative inconvenience of each available method to the individual user, or of the relative degree to which each method involves him in costs additional to the transport charge he actually pays.

"3. The function of the transport coordinating organization, therefore, should not be to make the choice of method itself. The choice must in general be left with the individual user; and the task of the transport coordinator should be to ensure that his choice is guided by knowledge of the relative amount of national resources used up by having onemethod of transport or another in each particular case. In short, coordination means enforcing a structure of relative charges (for given services by road and rail) which reflect their relative costs.

"4. We have noticed that the actual structure of charges has been gradually shifting towards this ideal, and that the 1953 Transport Act provides the opportunity for a further shift towards it on the part of the railways -- the section of the transport system where charges

on different services have always most markedly diverged from their costs." (Ibid., pp. 156, 157.))

44. Freedom of choice, and the use of cost-of-service rate making, ensures transport coordination, whereas the suppression of either condition would have the opposite result. This is recognized by prominent railway executives:

"No effective substitute has yet been found to replace price competition in deciding what companies should get a customer's business. Certainly no concept of regulation by government can hope to allocate traffic among different carriers with equal efficiency or justice."

(The Widening Way, address by Daniel P. Loomis, president, Association of American Railroads, before the New York Society of Security Analysis, May 8th, 1959.)

45. The same point is made by Dr. Solandt:

"If we cannot minimize Canada's total transportation bill, at least we can reduce it. Three obvious things that can be done are:

(1) Strive continually to improve productivity of both labour and equipment in every means of transportation in order to minimize real costs:

(2) Seek gradually to adjust the rates charged to the shipper so that in all cases they

represent the real cost of transportation plus a reasonable margin of profit:

(3) Educate all shippers to seek the most economical means of shipment to meet their particular problems. I use here 'economical" in its proper sense. I do not mean the cheapest form of transportation, since the cheapest form of transportation may not always minimize total costs."

(Frugality in Transportation, address given by Dr. O.M. Solandt, vice-president, Canadian National Railways, at the annual banquet of the Faculty of Commerce, University of British Columbia. Feb.13,1958 (mimeo.) p.3.)

46. It is in the public interest that the transportation system of Canada be operated at the lowest possible cost, and this will be done by the shippers using the system if they are given free choice and if prices are based on costs. It is also in the interest of shippers and the community as a whole that the full utilization of present capacity be achieved. This objective will be more completely gained through cost of service pricing rather than through any other system. Pricing according to the value of commodities will not achieve this desirable result. Given present capacity, the shift away from railways of high-rated traffic will result in overutilization of highway carriers and underutilization of railways. As one economist says:

"From the public point of view, the folly

of a rate policy that does not permit an important segment of the transport system to utilize economically its capital resources, is not only that private investment losses are suffered and that this continuous attrition creates a dismal and unproductive attitude among railroad personnel but that resources are over-allocated to competing modes of transport resulting in, for example, the congestion of the highways. And economic tragedy is that significant amounts of low cost transportation output are gone forever."

(Robert A. Nelson, "Administered Rates and Competition," reprinted from Official Proceedings of the New York Railroad Club Inc., December, 1958, p. 8.)

47. Through any such pricing policy, the high-cost rather than the low-cost agency will be used and less transportation can be purchased for a given expenditure by the country as a whole. This result is not merely the opposite of transport co-ordination and misallocation of economic reso rces but is a system which enables high-cost firms to remain in business or at least helps them to get traffic which they would not obtain with cost-oriented rates. This has the effect of keeping capital and other resources employed in a relatively inefficient use where sound economic policy for the country dictates that resource adjustment takes place

from inefficient uses to efficient ones. This point of view is supported by the recent U.S. Department of Commerce study on Federal transportation policy:

"The achievement of maximum efficiency in transport has become a complicated problem. For the growing opportunities contributed by the improved methods and technologies of transport have been accompanied by growing complexities within the transport industries as well as in the governmental policies which affect them. At a given level and structure of capital investment, efficiency requires that traffic be distributed among motor carriers, railroads, water carriers, pipelines, and air carriers in such a way that each type receives the traffic which it can carry with the least consumption of resources by the carrier for the service standards required by the user. It requires also that several forms of transport be used in coordination where such a combination can produce a better service-cost result than any single form working alone. Finally it requires that every enterprise participating be ably and energetically managed."

(Federal Transportation Policy and Program, op. cit., p. 2.)

48. In conclusion, it may be safely said that

cost-related rates will bring about greater efficiency, lower total cost, and better coordination than any other rate structure.

CHAPTER 7
IDENTIFICATION OF COSTS

Cost Concepts

49. Various cost concepts are used in the ensuing discussion and it is desirable to define them:

(a) Variable Costs. -- Costs which, in the aggregate, vary with output.

(b) Average Variable Costs. -- Total variable costs for any output divided by the output.

(c) Fixed Costs. -- Those costs which are, in the aggregate, absolutely fixed when a change in output takes place. In effect they are the aggregate amount of costs which would be incurred by the firm even if no output took place.

(d) Average Fixed Costs. -- Total fixed costs divided by the output.

(e) Total Cost. -- Fixed cost plus variable cost. When divided by output this is often termed "fully allocated cost," though this is a contradiction in terms as fixed costs can never be identified with a particular output.

(f) Marginal Cost. -- Strictly speaking, marginal cost is the extra cost of the last unit

of output produced, or, to put it differently, the expense that might be saved by cutting one unit from the total volume of production. The similarity of the definitions of variable cost and marginal cost may be noted. The marginal cost for the last unit of output is the same as the variable cost of that unit. However, when the variable costs are averaged over all the output, the resulting average variable costs do not correspond to the marginal cost of the additional unit of output.

(g) Out-of-pocket Costs.-- The term "out-of-pocket costs" is probably the most familiar term to transportation practitioners and regulators. Out-of-pocket costs are defined as those extra costs which are incurred by reason of the transportation of a particular lot of goods, which would not have been incurred if the goods had not been transported.

This definition of out-of-poc et would correspond to the definition of marginal cost if only one extra unit were transported. If the additional output referred to the entire transportation of a particular commodity, out-of-pocket cost would correspond to average variable cost if divided by the output.

(European costing experts turned to the use of out-of-pocket costs in the costing of transport operations. This they term "partial cost" -- the average cost of additional production. United Nations, The Problem of Cost in the Inland Transport Industry, Vol. 1, Economic Commission for Europe Transport Committee, 1954. p. 18. The British Transport Commission uses the terms "direct" and "indirect" costs, which roughly correspond to out-of-pocket costs and overheads. On this, see A. W. Tait, "Costs and Charges," British Transport Review, April, 1955, pp. 339, 340.)

As the out-of-pocket cost per unit of output (e.g., per ton-mile) is often required, it is usual to use the terms "average variable cost" and "out-of-pocket cost" synonymously. The I.C.C. evidently does this:-

"A study of Commission opinions indicates that 'out-of-pocket' costs are, in fact, average variable costs, although the Commission has often used language implying marginal costs. . . .

"As will be seen, however, computations introduced by the carriers before the Commission to establish out-of-pocket costs have, without exception, really been concerned with average variable costs; and the Commission, regardless of its language, has employed the term 'out-of-

> pocket costs' to denote average variable costs. . . .
>
> "Despite its ambiguous terminology the Commission has consistently used the term 'out-of-pocket' expense to denote the average variable cost of additional traffic."

(G. Lloyd Wilson and J. R. Rose, "Out of Pocket Costs in Railroad Freight Rates," Quarterly Journal of Economics, 1945, p. 559.)

For the purposes of this submission, in view of the foregoing, out-of-pocket costs will be taken as average variable costs for the output under consideration.

(h) Joint Cost. -- Joint costs are costs incurred jointly by two types of service, in that one cannot be produced without the other. An empty return journey is a joint cost which is incurred because the outward journey was made. The cost of either the outward or the return journey (apart from small directly allocated costs such as are incurred in passenger-handling, loading freight) cannot be isolated. All that can be done is to allocate the joint cost over the total traffic in both directions.

(i) Common Cost.-- A common cost is one that is incurred by two or more services, for instance, passenger and freight services. A

joint cost is inevitable -- if A is to be produced then B must also be produced -- as in the case of a return journey. But a common cost is not inevitable. If A is to be produced, then it is not inevitable that B is also produced. The operation of passenger services over a line does not mean that a freight service must also be produced. If the railway company chose to run only passenger trains, the cost could be directly allocated to passenger services. If the line is used also to run freight trains, the costs of the track, signalling, and some of the station expenses become common costs. The cost can be set against the aggregate movement of the traffic, but it cannot be precisely allocated as between passengers and freight.

(j) Overhead Costs. -- When the marginal costs have been separated from total cost, the remaining costs may be termed "overheads." This is a term used to describe those indivisible costs which cannot be directly allocated to particular units of traffic. It, therefore, includes elements of fixed, joint, and common cost. It also includes elements of variable costs when the unit of output is larger than the resulting unit of cost. For example, direct labour

is a variable cost, but it is overhead when the cost of one passenger is being considered.

50 A tenet of cost-oriented rate making is that rates should not fall below costs but there are many different cost levels. Fixed, joint, common, and overhead costs are obviously not the relevant costs on which to base minimum rates. This leaves out-of-pocket costs (synonymous with average variable costs), marginal costs, or average total costs.

51. The use of marginal cost as a minimum rate is impractical as it would involve a different rate being quoted for each unit of output if marginal costs were not constant. (But this is the only argument against marginal cost as a pricing standard. The economists' case for marginal cost rests on the ideal of competitive pricing when marginal cost is equal to the price of the service. By this method the maximum utility and benefit is obtained. Some economists go so far as to say that only marginal costs should be oovered by rates and the overheads by payments from general taxation. A protagonist of this view says: "One advantage of the system of charging only marginal "cost would be a great simplification of the rate "structure. . . . Regardless of their own history, the "fact is that we now have the railroads, and in the main "are likely to have them with us for a considerable time "in the future. It will be better to operate the "railroads for the benefit of living human beings,while

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letting dead men and dead investments rest quietly in their graves, and to establish a system of rates and service calculated to assure the most efficient operation." (H. Hotelling, "The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates," Econometrica, July, 1938, pp. 264, 269.)) Minimum rates in any cost-oriented pricing system should be related to out-of-pocket costs. It is these costs that are incurred if the output takes place. If they were not recovered in full, therefore, out-of-pocket losses would occur, and the railway would be better off by not carrying the traffic. A strong advocate of out-of-pocket costs as the jumping-off point for pricing is Merril Roberts:

"The path to economic efficiency lies in market-oriented prices or in administered prices that are patterned after them. The pursuant of efficiency requires basically that (1) out-of-pocket costs be recognized as the relevant cost measure in competitive pricing and that (2) these costs be fully asserted in the interests of low-cost carriers and shippers, as well as of society at large.

"Fully distributed costs are a false pricing standard because of adverse effects on revenue generation. It is quite meaningless to establish as a norm for rates a sum composed of out-of-pocket cost plus an arbitrary pro rata share of the overhead. . . .

In many circumstances a rate lower than the fully distributed costs yields a greater total contribution to profit than one which equates with this statistical allocation."

(Merril Roberts, "Regulation and Economic Efficiency," report of speech in Traffic World, April 4th, 1959, p. 26.)

Although Dr. Roberts had in mind the regulation of intermodal competitive pricing, his analysis is basic to the whole question of transportation rate making.

52. Average total costs are not a proper level for minimum rates. Once the railway has committed investment in fixed facilities it can haul traffic at anything above out-of-pocket costs and thereby obtain a contribution to its fixed costs. If average total cost pricing were the minimum legal standard, output would have to be reduced considerably and the fixed costs shared over fewer shippers. Any contribution to fixed costs over and above out-of-pocket costs lessens the sum to be recovered from all other traffic and so has beneficial effects. Dr. Pegrum makes this point in an earlier article:

"Minimum rates that attract traffic which increases the net revenue of the carrier that can get it are in the public interest and are a necessary part of public policy that relies on competition. These rates are also a necessary part of public policy which aims at

distributing traffic according to 'inherent' advantages. The fact that the minimum rates are based on costs which are below 'average' is not a relevant consideration."

(Dudley F. Pegrum, "Do we Have a New Rule of Rate Making," Traffic World, February 7th, 1959, p. 54.)

Out-of-Pocket Cost Identification

53. If out-of-pocket costs are the appropriate level of costs for minimum rates, the identification of such costs presents a problem. In order to identify such costs, the time period for which it is desired to identify the costs must be established. Average total costs of railway working are made up of average fixed costs and average variable costs, with out-of-pocket costs corresponding to the latter for any particular output. No clear-cut division into fixed and variable costs can be made without reference to the time period being considered. The longer the period, the smaller the fixed element until all costs become variable. Conversely, in the very short period nearly all costs become fixed. Early transportation economists thought that a large proportion of railway costs were fixed, even in the long run. (For exmple, W. Z. Ripley in Railroads, Rates and Regulation, New York, Longmans, 1912, pp. 54-55, and W. M. Acworth, Elements of Railway Economies, Oxford, Clarendon Press, 1911, p.50.) Later studies, however, show that railway costs are largely variable, even in a fairly short period of time. (H. Ashton, "Railroad

Costs in Relation to the Volume of Traffic." American Economic Review, June, 1940. W. A. Timmerman, Railway Expenditure and the Volume of Traffic, London, The Locomotive Publishing Company (no date), p. 22; E. J. Broster, "Variability of Railway Operating Expenses," Economic Journal, December, 1938, p. 680; and I.C.C. Bureau of Accounts and Cost Finding Statement 2-48, Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs, October, 1948.)

54. It is clear that as the length of time is increased, the more costs become variable. The out-of-pocket costs for any particular traffic taken over a period of twenty-four hours will be a much lower proportion of the total than if the period were one year. It is therefore essential that a long enough period of time be taken in order to get a representative picture of out-of-pocket costs for railway operations. This being so, it is suggested that long-run out-of-pocket costs are the appropriate measure for use in the cost of service rate making. The long period should, moreover, be long enough so that small business fluctuations in the economy are averaged out, say, two or three years. Taking the long-term view has the beneficial effect of reducing the fixed costs which have to be allocated, while increasing the proportion of out-of-pocket costs which can be identified with traffic.

(Other factors must also be considered when

deciding what proportion variable costs are to the total. One is output in relation to capacity because as output increases or decreases then the proportion of total costs which are variable also fluctuate. A small pioneer line with light traffic would have a much larger proportion of fixed costs than a well-established, heavily used line. As a railway outgrows the pioneer or feeder line stage its size becomes adjusted to the volume of traffic being handled. Then, as traffic fluctuates over a period of years, variable costs are a high proportion of total costs. It is also necessary to define the output unit when stating what proportion variable costs are to the total. Generally costs will vary much more for the output unit (e.g., a train mile) than for a pricing unit (e.g., a ton-mile or 100 lb. mile). As the railways cannot sell train journeys this leaves a large portion of the out-of-pocket costs indivisible among the sales units. It is not correct to assume, however, that because they are indivisible, or overhead costs to the individual sales unit, that they are fixed costs. It is suggested, therefore, that out-of-pocket costs for large output units be ascertained and then averaged among the individual sales units included within that output. Then, if we have out-of-pocket costs of \$x per train journey and y ton-miles, the out-of-pocket cost per ton-mile averages $\$\frac{x}{y}$. Hence, although it is clearly impossible to identify particular costs with particular consignments, it is not impossible to identify out-of-pocket costs for an

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aggregste of ton-miles included within the output unit. In this way, out-of-pocket costs are identified and ass'gned, leaving a much smaller proportion of overheads than would otherwise be the case.)

55. The discussion of variable costs leads now to the factors which make for differential costs, the implication being that differences in costs should be reflected in rate differences. Differences in costs which should be reflected in rates arise because of differences in routes, terminal handling costs, empty movements, length of haul, and weight.

Route Costs

56. Value of commodity pricing was shown to be inefficient in divorcing prices from costs, one of the criticisms being that competitors take away the high-valued commodities, leaving the railways with low-valued traffic. Exactly the same process occurs when the railway does not allow variations in route costs to be reflected in rates. On routes where rail costs are high but rates are low, traffic is attracted from relatively low-cost competitors, thus leading to economic waste. On the other hand, the railway will lose traffic on routes where rates are high but costs are low. It is essential, if this result is to be avoided, that variations in route costs be reflected in rates. It is probable that out of all aspects of railway working the range of costs encountered on different routes is the greatest. Light-traffic routes will have high average total costs per unit of

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traffic and high-density routes (assuming there is no congestion) low average total costs. The significance is that as railway rates today are broadly averaged over the different routes, whether high or low density, the result is rates which are above costs on the former and below costs on the latter. This encourages trucking along the high-density routes where rail rates are high in relation to costs and a waste of economic resources. Unless railways do allow route cost differences to be reflected in rates, they will continue to encourage truck competition along what should be their most profitable lines, while they will be left with unremunerative traffic elsewhere. These consequences were seen twenty years ago by R. A. C. Henry:

"The second major problem concerns rates. It is apparent that the relative charges for the different types of transportation service are most important in determining the division of traffic between them. Therefore, unless rates for each form of transportation bear approximately the same relationship to the costs of each, it is not possible for them to find their individual economic positions in the whole transportation system. For example, to the extent that motor carriers have approximated railway practices in rate making they have not made full use of their opportunities to find their ecoomic sphere of

activity, for their costs are different. On the other hand, to the extent that motor carriers have based rates on their costs they have diverted high rated traffic from the railways because of the important place the value of service principle plays in the rate making policy of the latter. . . . continuation of present practice is undermining the whole railway rate structure and at the same time fails to ensure the best development of all forms of transportation from a national point of view."

(R.A.C. Henry, Railway Freight Rates in Canada, prepared for the Royal Commission on Dominion-Provincial Relations, Ottawa: 1939, p. xxii.)

57. Costs tend to be lower on high-density lines as against those with low-density primarily because all capacity is utilized. Hence the fixed costs can be spread over a greater volume of traffic.

58. There is general agreement that costs are lower on routes where the density is high, providing it is not so high as to cause congestion. C.P.R. made the point in their brief to the Turgeon Commission. (Submission of Canadian Pacific Railway Company to the Royal Commission on Transportation, Montreal, 1949, p. 4.) High density also reduces costs in that because of the heavy traffic there is a greater probability that full trains can be made up for one destination, whereas on light-traffic routes, cars for various destinations will be included in one train.

Thus, the expenses of switching and terminal handling are reduced as well as numerous other costs.

59 There is ample evidence to show that the transcontinental lines enjoy favourable traffic densities, not too light to incur high unit costs, nor too heavy to cause congestion on lines and in yards. The C.P.R. submission of 1949 shows this well, in terms of net ton-miles. (Ibid., Appendix to Part I, p. 3, Map of Freight Traffic Density, 1948.)

It can be seen from the map in the submission that British Columbia is favoured with very few lines of low density when compared with the prairie provinces. The Canadian National Railways also submitted a map showing that British Columbia had the lowest mileage of low-density lines in Canada for the system in terms of gross ton-miles. (Canadian National Railways, Submission to Royal Commission on Transportation, Montreal, 1949, Exhibit A.)

60. Tables XVIIA and XVIIB submitted by British Columbia to the present Royal Commission show that the province has the highest-density lines of any district on the Canadian National lines and also has high density on the Canadian Pacific. This would indicate that, other things being equal,average total costs of hauling British Columbia traffic are low. Table XXXII indicates that in terms of originating freight tons per mile of track British Columbia stood fourth in density among all the Provinces and first in the Western Provinces in 1957.

TABLE XXXII

Originating Freight Per Mile of Track, by Province, 1957

Province	Freight Originated	First Main Track Mileage*	Originating Freight Per Mile of Track
	Tons	Miles	Tons
Quebec	41,508,960	4,939.8	8,402
Nova Scotia	10,733,635	1,391.4	7,714
Ontario	67,342,501	10,516.0	6,403
British Columbia	11,942,334	4,015.1	2,974
New Brunswick	4,589,410	1,798.7	2,551
Alberta	12,584,710	5,680.1	2,215
Newfoundland	1,596,093	934.6	1,707
Saskatchewan	13,870,471	8,720.8	1,590
Manitoba	7,853,204	4,974.0	1,578
Prince Edward Island	321,687	284.8	1,129

*Note--First main track mileage at December 31,1956

Source: Annual Summary of Monthly Car Loadings, 1957, D.B.S., Ottawa. Railway Transport, Part III, D.B.S. Ottawa.

Population, Congestion, and Terminal Costs

61. Apart from traffic density making for variations in route costs which should be reflected in rates, population density has an effect on costs. (The most densely populated area in Canada is the Lower Great Lakes and St. Lawrence lowlands, where nearly two-thirds of Canada's population live. The highest concentration of population is in the lowlands of Southern Ontario and Quebec, predominantly on the north shore of Lake Erie and Lake Ontario and thence

downstream along the St. Lawrence River to Montreal. This area contains about 65 per cent of the total population. (Computed from "Population of Provinces by Census Divisions, 1956," Canada Year Book, 1957-58.) Of the fifteen metropolitan areas in the country, only five are west of Lake Erie. Moreover, the population of Montreal alone, 1.62 million, or Toronto with 1.36 million, almost matches the population of the combined five metropolitan areas of the West, which is 1.65 million. "Incorporated Cities, Towns and Villages Having Populations of 1,000 or over by Provinces, 1956," Canada Year Book, 1957-58, pp. 128-132. The core area of Canada may be thought of as the district north of Lake Erie bounded by Windsor, Sarnia, Toronto and Hamilton. This area contains 19.8 per cent of the population, yet is only 0.4 per cent of the area of Canada. Edward L. Ullman, American Commodity Flow, Seattle, University of Washington Press, 1957, p. 7.) High concentration of population often has the effect of increasing land values, thus making railway building and extensions expensive undertakings. It also leads to traffic congestionon the highways leading to the stations, thus making for high pick-up and delivery costs. The lack of space and heavy traffic flows, the need for switching cars for many destinations, the provision of siding facilities for equipment needed in traffic peaks, all make for expensive railway working in congested areas. The commuter problem arises in these cities, with consequent losses both in commuter services

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and in lost time and opportunities giving these trains priority over freight equipment.

62. The problems of congestion were well brought out by Mr. Donald Gordon when he appeared before the Committee on Railways, Air Lines and Shipping:

> "Mr. Gordon: Commuter traffic is a special degree of headache.
>
> "Mr. Robertson: I take it that commuter traffic is around the larger cities?
>
> "Mr. Gordon: Yes, it is only at a place where there is heavy traffic density that we are involved with commuter service. We have been getting out of it wherever we can. We abandoned the Montreal-Southern Counties service over the last few years."

(Sessional Committee on Railways, Air Lines and Shipping. Minutes of Proceedings and Evidence, No. 1, House of Commons, 1st Session, 24th Parliament, 1958, p. 62.)

And speaking of congestion in more general terms:

> "Mr. Smith: I am thinking more in respect of short lines such as the 60 miles from Toronto and Orillia.
>
> "The Chairman: In that 60 miles you have about six stops and starts.
>
> "Mr. Gordon: Again you have to know the locality. Take an area around Toronto. The difficulty there is it is terribly congested. We are almost at the point of saturation on our line between Toronto and Hamilton. We could not

put more trains on there. We would have to build another line. Remember always that while most people are intrigued about passenger service, our bread and butter is freight; only about 8 per cent of our actual earnings come from passenger service. While naturally we have to give the passenger trains the right of way, from the railways' standpoint it is the freight we want to move."

(Ibid., p. 75.)

63. It would appear that the worst congestion is around Toronto, and the situation makes for very high costs. For example:

"Mr. Gordon: . . . We have got, we think, most of our terminal congestion problems solved, with the exception of Toronto. We are still struggling to find a solution in the City of Toronto, which we have not yet arrived at. . . .

"Mr. Fisher: What is the Toronto problem under discussion?

"Mr. Gordon: Congestion and the fact that no plan was made thirty years ago. The real trouble in Toronto was that if there had been proper planning thirty years ago this would not have arisen, but now the city is so built up there is no place we can find in which to establish a yard. All yards have been concentrated down around the lake-front and everything now has to come in to the lake-front and out again. It is like spokes in

a wheel, and we are now working with planning authorities to see what the remedy is. We have outside consultants examining the problem with us. I do not know what the solution is going to be. It may be we will have to go into a series of yards to carry the traffic, but we would prefer one large hump yard if we can find the area."

(Ibid., pp. 122, 123.)

64. These problems of congestion, mentioned by Mr. Gordon, lead to high terminal costs in certain areas. Variations in terminal costs should be reflected in any freight rates structure in order to encourage traffic to move through low-cost terminals and so that high-cost terminals are not subsidized by shippers who do not route traffic through them. If terminal costs are not specifically recognized in the rate structure, there is the danger that they will be subsidized also by line-haul operations. This is a danger where traffic using terminals is competitive with trucks while line-haul operations of bulk commodities are not. The rates for traffic moving largely through terminals will be held down while the line-haul rates are allowed to rise. Not only are line-haul costs low in relation to terminal costs, but the relative difference is likely to become wider with the passage of time. Dieselization, heavier rail, centralized traffic control, better ties, continuous track, etc., bring about lower line-haul costs, while

in terminal and yard operations the effect of rising labour costs nullifies the productivity of new equipment. As one researcher notes:

> "Great changes have taken place in the distribution of rail costs. Terminal costs have gone sky high as labour rates have risen, while dieselization and other improvements have held line costs steady. Virtually nothing has been done to revise the rates on traffic formerly profitable but now deficit producing. The railroads should conduct a continuing review not only to keep themselves profitably competitive, but to eliminate and correct developing losses."

(Alan M. White, member, Railroads' Tariff Research Group, in Traditional Differentials in Railway Rate Making. New York: Simmons-Boardman Publishing Corporation, 1956, p. 4.)

65. The charging of proper terminal costs is important from another point of view -- that of achieving proper coordination between different transportation media. Mr. Ponsonby brings out this point:

> "This seems to be an appropriate point at which to emphasize the importance of imposing appropriate charges for terminal costs, including in particular the cost of transferring traffic from road vehicle to railway wagon and vice versa. The fact is that these costs, especially the latter, are very substantial,

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and unless they are fully reflected in a railway charges scheme, traffic may well be drawn on to the railways, which in the national interest (which surely demands that traffic should pass from origin to destination by the least costly mode(s) of transport) should pass by road from door to door. We are now, of course, considering that large proportion of traffic which starts and finishes its journey by road, but passes by rail for the middle part of its journey.

"Assuming that once on rail the costs of carriage per mile are substantially less than by road it by no means follows that the traffic should pass by rail. Even if it costs virtually nothing to haul traffic by rail, it might still be more economical to send it all the way by road between two points because of the costs of the short road haul at each end plus the costs of transferring the traffic from road to rail and vice versa -- quite apart from any considerations of superior qualities of service that may be provided by road, such as quicker delivery or less risk of damage. Unless the charge quoted by the railway truly reflects and covers the full costs of carting the traffic to the station, of transferring it into wagons, of hauling it by railways, and of the necessary

additional operations required for the final delivery of the goods at destination, then there is a danger that the traffic will pass by rail, when in fact on a cost basis it should have passed by road all the way. This, of course, illustrates what is meant when it is said that a railway freight charges scheme based on cost is a sine qua non to an appropriate coordination of road and rail transport -- if by coordination we mean that all traffic should move by the least costly and most preferred form of transport."

(Gilbert J. Ponsonby, "Towards a New Railway Charges Policy," Journal of the Institute of Transport, London, September, 1954, p. 432.)

Distance

66. Apart from traffic density and terminal conditions as factors which affect costs, the length of haul is a variable which should be reflected in railway rates if they are to be based on a cost of service principle. This is reflected at present in tapered rates, arising out of the spreading of terminal handling costs over the line haul. However, the taper on account of terminal costs is not the only rate reduction which should be granted to long-haul traffic. Such traffic should get the advantage of better utilization of equipment. The short-haul equipment spends most of its time in yards for one reason or another, the equipment in long-haul transit,

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on the other hand, being utilized for the movement of traffic for a much longer period. Further, crews can be better utilized on long hauls, while short-haul crews spend a large proportion of time waiting.

67. Locomotives used in long hauls incur lower maintenance and fuel costs per locomotive-mile than equipment used on short hauls or in yard service and line is better utilized. (A. E. T. Griffiths, "Cost Variations in Transport: A Comparison of Road and Rail," in British Transport Review, December, 1957, p. 562, notes that the fuel cost per mile of a fast train is often lower than for a slow train because of fewer stops.) Acworth says:

> " . . . long hauls get mileage out of engines, wagons, train staff, etc., than a number of short hauls, necessarily with waits between; engines and wagons are better loaded; and the traffic is spread more evenly over the length of the line."

((Acworth, op. cit., footnote, p. 131.)

68. On the same point Pigou is in agreement:

> "Finally, it is proper that the rate for carrying from A to B goods that are to go forward to C on the same line should, in general, be less than the rate for so carrying goods destined for consumption at B. In so far as terminal changes are paid for in the rate, this is obvious,

because on the former class of goods, terminal changes at B are saved altogether. Even apart from terminals, however, the journey from A to B, as part of a longer journey, is less costly than the same journey undertaken as an isolated whole. The reason is that, roughly speaking, the interval of idleness for engines and plant, following upon any journey, involves a cost properly attributable to that journey, and the length of the interval does not vary with the length of the journey which it follows."

(A. C. Pigou, The Economics of Welfare. London: Macmillan & Co., 1952, p. 293.)

69. So apart from taper due to terminal costs there are other reasons why long-haul traffic should receive such benefits. That this length of haul should be reflected in transportation charges is a sine qua non in a cost of service method of rate making.

Loadability

70. Another difference in cost which should be reflected in rates is the load per car achieved, on the average, by any type of traffic over any particular route. This characteristic is termed "loadability" by the British Transport Commission, and defined as "bulk in relation to weight . . . the differing extent to which a given weight of different

goods absorbs the cubic capacity available in a normally used truck." (J. R. Sargent, British Transport Policy. Oxford: The Clarendon Press, 1958, p.23.) If a boxcar could move 30 tons of bricks or 3 tons of feathers, other things being equal, the feathers are ten times more costly to move than the bricks. From this point of view, minerals, grain, or lumber make better carloads relative to capacity than most manufactured goods which may be of such a shape or construction that their density is low in relation to bulk. If it costs the same to run a car-mile whether the car be fully or lightly loaded, then each type of traffic should bear its proportion of the cost; i.e., the feathers should pay a rate ten times more than the bricks.

71. Higher loads per car could also be attained by incentive rates, the rate per 100 pounds being less as the weight of any class of goods increases. The cost-reducing effects of higher loads per car are strikingly illustrated by Healy:

> "A second aspect of costs of importance to price patterns is the relation of vehicl loadings to unit costs. This rests in part upon the technical nature of resistances to movement which do not increase in proportion to increasing loads. Also, such added resistance to movement as there is involves in the main only increased line-haul motive power costs and loading has little effect

on terminal costs. The significance of all this is suggested in the ICC cost finding data. The estimate of out-of-pocket costs to move an average boxcar in the east 500 miles with a 10-ton load is $149 and only 17.5 per cent more, or $181, if the load is trebled to 30 tons. The cost per 100 pounds for the 10-ton load is 74 cents and for the 30-ton only 30 cents. Between the extremes of 7 tons and 50 tons found in actual traffic the unit costs go from 103 to 21 cents per hundredweight."

(Kent T. Healy, "Discriminatory and Cost Based Railroad Pricing," American Economic Review, May, 1957, No. 2, pp. 433, 434.)

72. There would not seem to be sufficient incentive under present charging policies to load cars fully, and thereby obtain cost economies. Whereas the average capacity of freight-cars has increased, the minimum weights have often decreased in order to compete with truck competition. If a shipper can obtain the minimum carload rate for loading 24,000 pounds, he will often load that amount even though 80,000 pounds or more could easily be loaded into the car. Incremental increases in weight per car should be rewarded with corresponding incremental reductions in rates per 100 pounds. If such incremental rates based on increasing weights were fully adopted, there would be no barrier to moving the minimum carload weights downwards to meet competition.

73. Competition and its relationship to minimum carload weights is discussed by Dr. Joel Dean:

"The railroads' greatest comparative advantage over trucks is on shipments too heavy or bulky to fit into a single truck van. Yet the typical tariff charges the minimum average rate per hundredweight for a 'carload' which is roughly the same size as a truckload. At most, the shipper is offered one or two alternative minimums, which encourages loading at such minimums but not beyond. On L.C.L. freight the lowest rail rate is for 5,000 pounds, so trucks get most of the traffic between 5,000 pounds and carload, which is the most profitable part of L.C.L. The railroads could increase their profits even on the traffic they already carry by sharing with shippers in the form of continuous incentives the cost savings of heavier loading per car and of multiple car shipments. Far greater profit improvement, however, should result from the traffic that such incentive rates would take away from the trucks.

"The magnitude of the opportunity for increasing rail profits by encouraging heavier loading is dramatized by recurrent freight car shortages. If the loss of revenue and goodwill were not so serious, it would be almost ludicrous to see car after car moving

half-empty during critical freight car shortages, while little is done to induce shippers to load cars heavier."

(Joel Dean, "Rail Costs for Intelligent Rate-making," Proceedings, Railway Systems and Procedures Association, 1959 Fall Meeting, p. 32.)

MULTIPLE CARLOAD SHIPMENTS

74. If it is logical to advocate lower rates for good loadability, it would also seem to be logical to advocate lower rates for multiple carloads. This point of view is taken by the Weeks' Report, which advocates competitive volume rates in the following terms:-

> "Recommendation. - Make lawful such volume rates as are based on cost differences, which rates are established to meet competition. The prime economic benefit of rail, water and pipeline transportation clearly lies in heavy long-distance and large-scale transportation. It is invariably cheaper to haul traffic in volume from one point of origin to a single destination. Heavier loading produces lower per-ton cost. The public is denied these cost benefits when obstacles are placed in the way of lower rates for volume movements. Consequently carriers should be permitted to make incentive minimum weights and volume rates, provided that such rates are open on equal terms to all who may wish to use them, and further provided that such rates meet the compensatory test. Price differentials having a suitable relation to cost are generally accepted in the pricing of goods and services in all parts of our economy. (Revision of Federal Transportation Policy A Report to the President. Prepared by the Presidential Advisory Committee on Transport Policy and Organization, April. 1955, p. 14)

75. In the interests of the small shipper who may be put to a disadvantage, this submission does not advocate the inclusion of multiple carload rates in tariffs. It is further believed that the competition can

adequately be met by agreed charges which make multiple carload rates unnecessary.

EMPTY RETURN CAR MOVEMENTS

76. Whether cars normally return empty or otherwise on a particular route or because of some particular traffic has a great bearing on costs. If there is normally a 50-per-cent empty return factor, out-of-pocket costs will be, other things being equal, twice as high as if cars were fully loaded each way.

77. There are, of course, many other things that affect costs which could be taken into consideration as traffic costing became more refined. Such differences in costs arise through perishability, fragility, explosiveness, invoicing costs, operating conditions, speed, seasonal fluctuations, etc. In summary the following points of view may be noted:-

> "An attempt has been made to outline a charges scheme based mainly on cost rather than demand factors. In the interests of simplicity there must be some 'averaging' and 'roundings off', and any such scheme can only reflect the big and substantial cost differences per ton-mile. The latter appear to arise mainly from:-
>
> "(1) Differences in loading capability.
>
> "(2) Difference arising from whether there is normally a 'return-load'; or otherwise.
>
> "(3) Differences in cost per wagon-mile resulting from whether wagons can be worked in large train loads over long distances,

and at speed, or in contrary circumstances.

"(5) Differences due to high terminal costs, such as shunting, clerical or other costs which arise per ton consigned or wagon dispatched.

"(6) Differences between peak and off-peak times, and between one direction and another.

"If the substantial differentials in charges, justified by these outstanding cost factors, were applied much would have been accomplished." (Ponsonby, op.cit., p.432

"While the profusion of exceptional rates makes any general conclusion difficult to draw it is to be doubted whether rates charged on rail freight traffic fully reflect the wide variation which exists in the costs incurred in the moving of different types of freight. It would appear -- as with passenger traffic -- that traffics which are long-distance, fast and regular subsidize traffics which are short distance, slow and irregular. Also larger consignments which are easily loaded subsidize small parcels and traffics, such as agricultural machinery, which are difficult to load. While this situation remains it is difficult to see how different forms of transport can be co-ordinated, or integrated, on an economic basis, i.e. on a basis which required transport services to be provided at least possible cost to the community."
(A.M.Milne, The Economics of Inland Transport. London: Pitman, 1955, pp. 153-154.)

78. So much for the problem of the identification of variable costs which should be reflected in the various charges for railway service. It is submitted that these out-of-pocket costs determine the minimum charges below which rates would not be allowed to fall.

Recovery of Overhead Costs

79. Even though there may be great refinements in traffic costing over the next few years, there will still be a sum of unallocated costs, or overheads, which cannot be identified with particular traffic. The overheads are:-

(a) Fixed costs occurring because the very long run, rather than a two-or three-year period, is not taken for costing purposes.

(b) Common costs, which cannot be assigned to passengers or freight; e.g., signalling costs on a jointly used line.

(c) Joint costs arising because of unbalanced movements of traffic, such as an empty return journey.

(This is the most usual type of joint cost arising in transportation though by no means the only one. There is the joint cost arising out of the journey between two intermediate points in a whole train journey. There is the joint cost of hauling empty cars and of

the waiting time between journeys. Staff, either operating or administrative, also incurs joint costs, and usually common costs also. The very term "joint" cost means that these sums, which are over and above the out-of-pocket costs directly associated with the traffic, cannot be allocated except arbitrarily. The problem diminishes in magnitude, however, with an increase in the output unit and over time.)

80. The following methods of distribution for overheads have been suggested, among others, from time to time:-

(a) Distribution according to the output performed; e.g., on the basis of ton-miles, tons carried, passengers boarded, etc. This method has disadvantages. If the distribution were on a ton-mile basis, the overheads would be

borne mainly by heavy commodities, as these provide the greatest tonnage and often have the longest hauls. Should distribution be on a ton or a passenger basis, this would burden the short-haul traffic as these are the majority of movements. For example, there are many more passengers travelling between Toronto and Hamilton than between Toronto and Vancouver, hence such a system would place most of the overhead burden on the former haul as the mileage would be ignored.

(b) Distribution of the overhead by a standard mark-up of the out-of-pocket cost incurred; e.g., by a 10-per-cent addition. This was the method suggested by counsel in the Western Rates Case, where "the Board was urged to base rates on cost plus an additional percentage for proper overhead or capital charges. (Henry,op.cit.,p.248.) The method has disadvantages. For instance, a mark-up of, say, $2 to overheads may actually, in the aggregate, produce less revenue than a mark-up of $1 because the latter may attract a much greater volume of traffic. Rates, and the contribution to overhead, can only be judged with reference to the tonnage which is being moved. Overhead allocation according to a percentage or mark-up formula is far too inflexible for practical rate-making purposes.

(c) Distribution according to the value of service, or the refinement of charging what the traffic will bear. This method has advantages if it is not abused. The railways benefit in that the contributions to overheads are maximized. It enables some service to be sold at low rates, and thus the high-rated traffic obtains lower rates than would otherwise be possible. It also has the advantage that the recovery is based on consumer demand; that is, by "not charging what the traffic will not bear" and by charging no less than the amount customers are willing to pay.

81. The method is infinitely superior, on all counts, to the other two. It does not unduly burden any class of traffic more than that traffic can bear, providing that the traffic is not captive to the railways. It does not necessarily burden short-haul as against long-haul traffic or vice versa, or bulky commodities as against good loading traffic. It is flexible in that when economic conditions change then the contribution to overhead can be changed. It induces traffic to move in the greatest quantities as against a flat or percentage addition to out-of-pocket costs.

82. The method of recovery according to what the traffic will bear has found favour with many authorities, some of whom may be quoted:-

Mr. W. G. Scott:-

". . . common and joint costs, like fixed costs, "must be recovered on the basis of the demand for

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"the service rather than the cost of the service."

(In J.C. Lessard, "Transportation in Canada," Royal Commission on Canada's Economic Prospects, Ottawa, 1956, p. 155.)

Mr. F. K. Edwards, former chief of the Cost Section, I.C.C.:-

"The problem is analogous to that of the steer which the American Meat Institute has been widely portraying lately in national news weeklies. If a steer costs $25.80 on the hoof (25.8 cents lb.), then why, it is asked, should porterhouse steak sell for $1, hamburger for 42 cents and hide and hair for something very much less. The problem is one of joint costs. The cost of the whole can furnish no meaningful figure either as to the cost of the parts or market prices on the parts.

"The answer, of course, lies in the intensity of the consumer demand for each product. This, and this alone, provides the test of what it takes to attract each class of consumer and to clear the market of the respective products and by-products. A fully distributed statistical cost of 25.8 cents per pound applied 'across the board' would receive scant attention in the market place by either buyers or sellers. The most that can be said for the hypothetical 'full cost' figure is that it is a point of departure."("Transportation Costs, Value-of-service and Freight Rates," I.C.C. Practitioners' Journal, March, 1954, p.496(quoted in Lessard, op.cit., p. 157).

Mr.David Blee, Commercial Manager, British Transport Commission:-

"It is a basic essential from the Commission's point of view that they should not be forced into

a decision of having to carry traffic at less than its direct cost . . .

". . . The general charging policy of the Commission, if this sort of scheme were approved and in operation, would be . . . that its rates should all be such as at least to cover the direct costs of the transport of the consignment concerned with a reasonable and proper contribution towards indirect costs according to the market, competition, and many other associated commercial considerations."(Transport Tribunal,B.T.C.(Railway Merchandise)Charges Scheme,1955. Minutes of Evidence,1786, pp.148-150,quoted by Sargent,op.cit.p.64.)

Mr.A.W.Tait,former Director of Costings, British Commission:-

"The general framework of the financial policy for actual charges under maximum powers will be that charges for groups of traffics, at any rate, should in general cover the direct costs of operation, as we define them, and make such contribution towards indirect costs as can be got, subject to the administrative control of both charges and operations, to ensure that the total indirect costs are covered . . . The indirect costs would be allocated according to the market to the various traffics. (Ibid, p.64.)

Mr. Dudley Pegrum, Professor of Economics, U.C.L.A.:-

"Costs must also be considered from the standpoint of their traceability to output. Some costs cannot be traced directly to output. To put it another way, responsibility for the incurring of

some costs cannot be placed directly and individually on the resulting products. These costs are what economists call joint and common costs. When such costs are incurred, they will have to be recovered on whatever basis the market will permit. The directly traceable costs will set the minimum for each of the resulting products and each should be sold at that price if nothing more can be obtained." (Dudley F.Pegrum,"The Special Problem of Inter-agency Competition in Transport," I.C.C. Practitioners' Journal, December, 1956, p. 311.)

Mr. G. Lloyd Wilson (late), Professor of Transportation, University of Pennsylvania:-

"It is suggested, as a practical matter, that fixed and variable costs be allocated among these services as accurately and completely as available cost data permit. The balance of the joint costs should be distributed according to demand for the respective services . . .

". . . it is suggested that the railroads take the following steps to assert their inherent advantages and competitive rights:-

"1. Study the costs of performing transportation services of various types, in different quantity units, in different levels of volume of traffic, in different areas, and in line and branch line services.

"2. Determine, within the limitations suggested, the allocation of costs, including joint costs.

"3. Estimate the elasticity of demand for

freight and passenger services of the types they wish to offer.

"4. Price their transportation services within the zone of reasonableness, with out-of-pocket costs as minimum rates, and the value of service or what the traffic will bear as maximum.

"5. Price the services produced under conditions of joint rates within the zone of reasonableness at the points determined by the demand for the services." (G. Lloyd Wilson, "Inherent Advantages - Summary and Conclusions", in Essays on Inherent Advantages of Railway Service, New York: Simmons-Boardman Publishing Corporation, 1954, p. 44.)

83. Though the recovery of overhead costs according to what the traffic will bear is sound in that it equates rates with the demand for service and at the same time maximizes railway receipts on each type of traffic, there is the probability that unreasonably high rates would be charged on captive traffic. In the absence of competition there is the danger that this traffic would be asked to bear a disproportionate share of the general overhead burden. This would clearly be contrary to the national interest, as was pointed out in the Report of the Royal Commission on Agreed Charges:-

"It may be urged that the solution to a situation

such as this (the capture of high rated traffic by trucks) would be the raising of the rail rates at the lower end of the scale, that is, upon such low-value commodities such as coal, gravel and other basic raw materials. It is doubtful that such a proposal would meet any degree of acceptance, or that it would be of benefit to the railways or to the country at large. It seems desirable that the maintenance of low railway rates on low-value traffic in the non-competitive field should be a prime requirement of the rate structure." (Report of the Royal Commission on Agreed Charges, Ottawa, 1955, p. 20.)

84. That captive traffic should receive special protection against unduly high rates is recognized by Professor Meyer:-

". . . the previous recommendation of a general relaxation in rate regulation should not apply to the carriage of these non-competitive rail bulk commodities and the power to limit maximum rail rates in such cases must be retained by regulatory agencies. In actuality, moreover, some rail rates in these sectors may be unjustifiably high today." (John R. Meyer, et al., The Economics of Competition in the Transportion Industries. Cambridge: Harvard University Press, 1959, p. 248.)

It is suggested, then, that although what the traffic will bear is a sound rate-making principle for the recovery of overheads, it is likely to result in unduly

high rates for captive traffic. As Meyer suggests, maximum rate controls should be retained for this class of traffic. Again, recourse is made to cost-of service rate-making, and it is submitted that maximum rates for captive traffic be no more than the fully allocated costs of moving such traffic.

85. The rate-making proposals put forward so far have, therefore, three essential ingredients:-

(a) Minimum rates for all traffic should be no lower than long-run out-of-pocket costs.

(b) Maximum rates should be published for captive traffic, and such rates should be no higher than fully allocated costs.

(c) Above the minima (subject to the maxima for captive traffic), recovery of overheads should be related to what the traffic will bear.

86. Problems immediately arise from these proposals, the main ones arising out of equalization of class and commodity mileage rates and the requirement that a railway may have to furnish evidence that competitive rates are no lower than necessary to meet competition. Another problem which may be mentioned is that any cost-oriented price structure does not have as its goal the preservation of long-established market relationships between various shippers. The preservation of such relationships is, nevertheless, of vital concern to many shippers, and this is not overlooked. It is obvious, however, that often market relationships cannot be preserved by

railway rates as the market position of one shipper vis-a-vis others is often set by the railway's competitors. Where such relationships are within the control of the railways, there is nothing in these rate-making proposals which would take away their power to continue preservation, as long as rates fell within specified minima-maxima. This applies also to present rate grouping. These will be dealt with in turn.

Equalization

87. The equalization of rates implies the differences in costs are not recognized in the rate scales. The difficulties which arise for railways when this is not allowed to happen are pin-pointed in the Lessard Report:-

> "A second way in which railway rates have reflected national considerations is by charging the same rate on all lines regardless of any differences in costs which may exist. In this way railway rates have promoted the development of many remote areas, as well as a uniform growth of the country's economy inasmuch as light traffic lines have enjoyed the same rates as heavy density lines.
>
> "The C.N.R. submission to the Royal Commission on Transportation, 1951, indicated that about 25 per cent of mileage failed to contribute anything to overhead costs while an additional 30 per cent was considered to be marginal. Therefore, virtually all of their overhead costs appear

to be recovered from the remaining 45 per cent of operations.

"This characteristic of the railway rate structure requires the railways to recover a high proportion of overhead costs from high density lines where costs are low, and is in effect a further application of the principle of internal subsidization. This situation does not prevail to the same extent for pipelines, water carriers, airlines and motor carriers.

"A third way in which the railway rate structure has been affected by national policy considerations has to do with the equalization of class rates. Over the years there have been variations in regional railway class rates reflecting differences in railway costs of operation or demand for railway services. Such considerations no longer have any application to railway rates as a uniform class rate structure is applicable to the whole of Canada, with the exception of the Maritime Provinces. Such losses as may be incurred in any one region because of higher operating costs must therefore be recovered from profits in other regions, and if in the process certain railway rates have to be maintained at an artificially high level, traffic thereunder must become progressively more vulnerable to competitive carriers which have no obligation to adopt a similar type of charging.

"Also in the interest of a uniform development

of the country, special assistance may have to be given to remote areas in the form of reduced transportation costs. Nevertheless these objectives, however desirable they may be, are becoming more and more difficult to achieve through railway rates, owing to the loss of the monopoly position of the railways over much of the nation's traffic. Further attempts to do so can only result in a progressive weakening of the railways' ability to compete effectively with other carriers. Railway internal subsidization as an instrument of national policy is no longer appropriate to today's competitive transportation conditions. Some alternative method will have to be found to achieve this objective if the railways are to adjust themselves effectively to the new competitive conditions and if equality of competitive opportunity for each carrier is to be meaningful. (Lessard, op. cit. pp. 89, 91.)

88. Value of commodity pricing was shown to be inefficient as it divorced prices from costs, one of the criticisms being that competitors take away the high-valued commodities, leaving the railways with low-valued traffic. Exactly the same process occurs when the railway does not allow variations in route costs to be reflected in rates. On routes where rail costs are high but rates low, traffic is attracted from relatively low-cost competitors, thus leading to economic waste. On the other hand, the railway will lose traffic on routes when rates are high but costs

are low. It is essential, if this result is to be avoided, that variations in route costs be reflected in rates, contrary to the principle embodied in equalization. As Mr. MacDonald says:-

> "From the economic standpoint there is no greater fallacy than the notion that freight rates per ton or per mile should everywhere be equal." (James A. MacDonald, "Technological and Economic 'Advantages,'" Essays on "Inherent Advantages" of Railway Service, op. cit.,p. 23.)

89. Railways, by equalization, are forced to average their costs over remunerative and unremunerative routes, which has the effect of making rates above costs on some sectors. Motor for-hire and private carriers are then able to profit by concentrating on rail low-cost high-rated traffic. Differential rates, reflecting differences in costs between routes, would rectify the situation and enable the railways to assert their competitive strength;.

90. As equalization results in identical rates, whether costs are high or low, the principle is not consistent with cost-related rate-making. While it is believed that in a monopoly era in which traffic costing was unsophisticated equalization had its uses, in competitive conditions equalization only results, through cross-subsidization, in the loss of low-cost and the attraction of high-cost traffic.

91. Professor Gilbert Walker criticized a similar situation in England when advocating a cost-oriented

rate structure some years ago:-

"But whatever may be the case between one class and another, and between consignments of different sizes, it is quite clear that the cost of carrying the same class of goods will vary between very wide limits indeed as between one route and another and between one pair of stations and another. With the one schedule of standard charges applicable throughout the country there is no possibility of a concession in favour of routes which, for one reason or another, are cheap to work per ton-mile of traffic conveyed nor of discrimination against routes which for other reasons are expensive. With the element in the rate for services at terminals varying only with the class of goods there can be no concession on traffic shipped through stations where handling costs are low, nor discrimination against traffic shipped through stations where handling costs a ton are high.

"But whatever the class of goods, and whatever the distance, the costs a ton-mile for trainloads shipped along the main line without stop between railheads will be low; the costs a ton-mile in broken trainloads to intermediate stations will be high, and costs a ton-mile in small and occasional consignments along branch lines higher still. Yet the schedule of standard and exceptional rates applies the same rate a ton-mile at the same distance when rendered in respect of the same class of

goods. (Gilbert Walker, Transport Policy before and after 1953." Oxford Economic Papers, N.S., 1953, pp. 95, 96.)

Rates No Lower than Necessary to Meet Competition

92. Cost-oriented rate-making is impossible if rates are to have more regard for the costs of a competitor rather than of the railway itself. It would be in the interests of the railway and its customers if rates were allowed to go even lower than this if the net revenue of the railway is thereby increased. Net receipts could be increased by reducing the rate, thereby attracting additional traffic and obtaining fuller plant utilization. Professor Dudley Pegrum supports this view:-

> "One further point with regard for differential pricing should be noted. Differential pricing should not be limited merely to what is necessary to meet the competition of the carrier of a rival agency. It will be to the interest of the carrier seeking to obtain the traffic, and to the public, for prices to go even lower than those necessary to meet the competition if the net revenue of the proposing carrier is increased as a result of the generation of additional traffic that will make for a fuller utilization of the carrier's plant. It is not in the interest of sound public policy and effective intermode competition to require that the moving carrier prove that it is justifiably meeting competition, not creating it. If, as a result of rate reductions, a

carrier is able to improve its net revenue position, it should be permitted to make such reductions even though this takes traffic from a rival mode. If competition is to be effective, carriers must be permitted to create competition, not compelled to be passive respondents to the initiative of others. (Pegrum, "Do We Have a New Rule of Rate Making," op. cit., p. 54.)

93. As competition gathers momentum in the years ahead, it should be made easier for railways to take advantage of their low costs where they occur.
It may be, for example, that a rate one day is contributing to overheads by a good margin, but the next day an unregulated carrier quotes a somewhat lower rate and clears the traffic. If the railways desire, they should not be hindered in quoting an even lower rate than their competitors in order to regain traffic, subject to the proviso that the new rates are above out-of-pocket costs. (It may be questioned that if a railway was maximizing receipts at the rate before competition, how could it now maximize receipts at a rate lower than necessary to meet the competition? Put another way, why should a railway wish to have rates lower than necessary to meet competition as rates that met the competition would surely maximize receipts? It is improbable that rates which met the competition would also maximize receipts as the demand curve for railway transportation is likely to have changed both its position and its elasticity. Even if marginal costs are

constant at any level of traffic, the new maximizing rate may well be considerably below the "competition meeting" rate.

94. Even though the railways may have low out-of-pocket costs relative to competitors, this submission does not ask that rates set because of competition be allowed to move right down to out-of-pocket cost levels. This is for two related reasons. In the first place, destructive competition could result by so-called predatory pricing by railways. The motor-carrier industry in Canada is in no position to stand any railway onslaught of selective price-cutting, and the loss of even one route by a motor carrier could have serious consequences for his entire business and body of customers. In the second place, captive shippers would suffer should rates move down to out-of-pocket cost levels, or even to levels where sufficient contribution to overheads was not forthcoming.

95. The question immediately arises as to what contribution to overheads is required from competitive rates. It is often argued that any contribution is advantageous for all traffic, as the contribution made by captive traffic is thereby lessened. This is true, but the position for the captive traffic could be much better than this in having the margin over out-of-pocket costs as great as possible. This does not necessarily mean that the rate should be as high as possible, of course, as a rate of $5 moving 10,000 tons will bring in less contribution to overhead than a rate of

$2 moving 30,000 tons. It is urged, therefore, that rates should be allowed to go lower than necessary to meet competition, but only to the level which will maximize the railways' receipts on a particular class of traffic.

96. The administration of a rule designed to prevent rates from going below those necessary to meet competition is, in any case, extremely difficult. It is not clear whether the term "meet" means to share the traffic with competitors or to eliminate competition. (Royal Commission on Transportation, 1951. Transcript of Evidence, Vol. 61, pp. 11526, 11538, 11539.) Even if sharing of the traffic is intended, a small error could quite unintentionally eliminate trucking competitors who, typically, do not have large resources. Does "competition" mean contract and privately owned transportation or the common carriers? The difficulties of regulators in ascertaining rates, let alone costs, for any of these media cannot be underestimated. Presumably service competition also has to be taken into account and this must involve a degree of judgment.

97. Presently there is nothing in Federal regulation that can prevent a trucking firm from further reducing a rate after the Board of Transport Commissioners has permitted railways to lower rates to the level necessary to meet competition.

Summary

98. To summarize, out-of-pocket costs, synonymous

with average variable costs in this submission, are accepted as the relevant costs for minimum rates. The identification of such costs presents problems which diminish as the time period lengthens. Hence the time period of two or three years is suggested for cost studies, a period which is long enough to average out normal fluctuations in railway business. Costs are seen to vary with route, terminal facts, empty car movements, loadability as well as with weight and distance, hence rates should reflect these differences.

99. The best way to recover overhead costs is by differential charging according to what the traffic will bear. This method maximizes receipts and traffic but leaves captive traffic open to exploitation. This being the case,it is suggested that maximum rates for captive traffic be limited to fully allocated costs. For other traffic, competition would provide an automatic ceiling rate. Cost-of-service rate-making is not consistent with equalized rates or with the possibility that rates go no lower than necessary to meet competition. These present practices lead to the loss of revenue and are neither beneficial to railways or their customers.

Chapter 8

Proposals for a new Rate Structure

100. Outline proposals for a new railway rate structure are suggested in order that rates may have due regard for costs. (Professor Clark had a somewhat similar cost of service structure in mind when he wrote: -

"The rate system (cost of service principle) is naturally confined to certain objective facts or criteria on which rates and rate differences are based. The first is governed by the classification. Different commodities may receive different rates, or the same commodity may receive different treatment according to the way in which it is packed and shipped. Here it is possible to take account of the special costs of loading and unloading, special care required in handling, risk of damage, and percentage of car capacity which the traffic utilizes. This last could be fairly well taken account of by a uniform haulage charge of so much per gross ton-mile, since traffic which uses only a small part of the capacity of the cars or which forces the road to haul cars back empty, would be charged accordingly, and each ton-mile charged against it for hauling the empty car.

"Secondly the size of shipment. Differentiation on this ground is severely limited in the United States, under a long-established ruling of the Interstate Commerce Commission, recognizing the difference between carload and less-than-carload shipments, but no other....

"The third objective fact on which rates hinge is the origin and destination of the shipment, and the distance covered. Here it is possible to make rates according to distance, whether on a uniform mileage basis or on a tapering scale, or by zones of differing widths. Such scales might be used in various ways, as minima or maxima, or both...

"It is impossible here to go into all the conditions affecting cost of service. These would include special types of cars, special loading equipment, expensive bridges and other structures, differences in topography, etc. All these would justify wide variations in charges." (John Maurice Clark, Studies in the Economics of Overhead Costs. Chicago: University of Chicago Press, 1923, pp. 290-293).

The basis of the structure would be four types of rate schedule:-

(a) Minimum rate schedules for all carload traffic.

(b) Maximum rate schedules for all carload "captive" traffic.

(c) Schedules of actual rates for less-than-carload traffic.

(d) Passenger fares to be incorporated into schedules with reflect costs of service.

Carload Minimum Rate Schedules.

101. The schedules should be based on long-run

out-of-pocket costs as previously defined. The foundation for these minimum rate schedules would be a classification of all carload merchandise, but cost factors would be the only criteria to be considered when assigning goods to various classes. The primary factors giving rise to cost differences between the carriage of classes of merchandise would be:-

(a) Loadability.

(b) Perishability.

(c) Loading possibilities with other articles.

(d) Type of rail car normally used in hauling the commodity.

(e) Susceptibility to damage.

In this classification, weight would also be taken into consideration.

102. The minimum weight for carloads should be specified (possibly starting at truckload quantities), and greater weights up to full carload lots. For each weight a rating would be assigned according to the percentage cost relationship of each weight to the cost of the full carload weight. For example, it might cost 50 per cent more per 100 pounds to haul a carload of 30,000 pounds as it would a carload of 60,000 pounds. If so, the smaller quantity would have a rating of 100 if the heavier carload rating were 50. The resulting classification would look very much like the present one, but with additional columns to give incentives for heavier car loadings, for example:-

CARLOAD CLASSIFICATION

Article	Rating				
	30,000 lb.	40,000 lb.	50,000 lb.	60,000 lb.	100,000 lb.
	100	80	70	50	30

103. The tariffs also would be constructed very much like those of today. In the tariffs, consideration would be given to the rating, distance, cost of terminal handling, and route costs, these being the main elements of cost (apart from weight) in railway operation. For example, the tariff would give the distance rate per 100 pounds for each rating for distance blocks. Superimposed on this would be arbitrary differentials to give effect to variations in terminal handling costs, switching costs, and routes normally employed, for example:-

DISTANCE FACTOR

Distance (Miles)	Rating				
	100	80	70	50	30
	¢ per 100 lbs.				
100-199	20	18	16	14	12
200-299	21	19	17	15	13

ARBITRARIES

Terminal Group				Route Group			
A	B	C	D	A	B	C	D
$ per carload				¢ per 100 lbs.			
40	50	60	70	0	2	4	6

104. A minimum rate would be found by addition. For example, a minimum rate for 50,000 lbs. of article X shipped 100 miles through two Group A terminals over Route B:

Rating	70
Distance rate	16¢
Route arbitrary	2¢
Total rate per 100 lbs.	.18¢

Plus terminal arbitrary (x2) $80 per carload. Total minimum charge for carload of 50,000 lbs. $170.

105. The terminal arbitrary would be assessed by the costing of traffic through a sample of terminals, the samples being constructed so as to include all the major ones. It is realized that each commodity does not cost the same per 100 pounds to handle, but such differences between commodities would be taken care of in the classification ratings. Differences between terminals, however, would be reflected in the arbitraries. (It is also realized that one commodity may cost more to handle through one terminal than through another, but instances where large differences occur would probably be rare and could be ignored for the sake of simplicity.) Terminals falling within certain broad ranges of cost would be grouped together and designated A, B, C, etc. A listing and grouping of terminals would, of course, be necessary. (Intermediate and interline switching is considered to be part of line-haul costs.)

106. The route arbitrary is intended to adjust rates for differences encountered in line-haul costs between various routes as compared with the lowest-cost routes. Hence, Group A routes are low cost while traffic moving on Group D would incur out-of-pocket costs of 6 cents per 100 pounds more. There is no reason to think that line-haul costs vary between commodities, and so there would be no need for refinement.

107. The route arbitrary poses some difficulties. For example, what is a route? A route is logically the originating point to the destination, but it would clearly be impossible to list all possible routes. It would not be impossible, however, to segregate costs for purely main-line traffic. This, presumably having high-density low-cost characteristics, would go into Group A. (A table of main-line stations is visualized showing main-line origins on one axis and destinations on the other. If it is necessary to exclude some hauls from Group A because, say, of low densities in one direction, this could easily be indicated. Greater than normal empty factors could similarly be penalized.) For other traffic rough grouping would have to suffice; for example, traffic having 80 per cent of the mileage from origin to destination on main lines would take Group A arbitraries. If only 60 per cent of the haul was on main lines, the group would be B, if 40 per cent Group C, etc. Alternatively, the main-line haul could be taken as Group A and the balance assigned

on a railway division basis. For example, if 50 per cent of the haul were on a main-line route, the rest of the haul being in, say Calgary Division, which may be in Group B, an arbitrary of 1 cent per 100 pounds would be part of the total rate, being 50 per cent of the Group B arbitrary.

108. A further problem is immediately apparent. As distance has an effect on costs, identical minimum or maximum rate schedules for competing routes, regardless of length, would not be possible if these proposals were adopted. Circuitous routes taking identical rates are suspect from the economic point of view, as Professor Williams points out:-

> "The aspirations of circuitous routes to share in the traffic, within certain defined limits, are gratified in the great majority of instances. As a result, depressed competitive rates which may produce tolerably satisfactory earnings over direct routes are extended to longer routes, roughly until a minimum reasonable basis is reached over the longest routes for which relief is granted. Such traffic as may be held or diverted from motor carriers by the reduced rates is thus dispersed over a variety of routes, some more economical than others, producing a variety of net revenues over the several routes and a total net to the participating routes which is unquestionably less than would result from the concentration of traffic over a few

of the more direct routes". (Ernest W. Williams Jr., The Regulation of Rail-Motor Competition. New York: Harper & Brothers, 1958, p. 103).

109. This situation, although descriptive of the United States, has truth in it when applied to Canada, even though we do not have the multiplicity of possible routings. If rates on the circuitous routes are the same as on the short-line haul, transportation is more expensive than it need be by virtue of the high-cost carrier being assured some business. As Professor James Nelson writes:-

> "The railroad industry is at its best, relative to trucks, when it is providing wholesale transportation. Dispersion of routing pushes the railroads toward retail transportation, and tends to dissipate the greatest economic advantage the railroads possess." (James R. Nelson, Official Proceedings of the New York Railroad Club, Inc. January, 1959, p. 21).

110. Under the cost-of-service scheme as proposed, railways would be free to quote the same rates for circuitous routes as for short-line mileages, providing that the rates came within the minima/maxima. The only practical effect would be that the mimimum/maximum schedules would be different for each route, but for competitive reasons the railways may, nevertheless, w ish to quote the same rate based on the short-line mileage.

Carload Maximum Rate Schedules.

111. It is suggested that maximum rate schedules be drawn up for captive traffic. Captive traffic is defined as traffic for which there is no reasonable competition other than rail. This would include carload movements now taking place at non-competitive commodity and class rates as well as traffic for which the only competition was another railway.

112. As competition grows in the transportation industry, the only changes would be from captive to non-captive classes, rather than vice versa. As traffic became non-competitive, the maximum tariffs would automatically become paper rates as rates were pressed down. If the railways wished to cancel the maximum rate schedules, however, they should have to apply to the Board. The grounds for application would be that reasonable competition had commenced for the traffic. The railways should, of course, have to show that the competition was not sporadic and that the competitive rates were rates which actually moved the traffic in some volume.

113. Should any shipper, or association of shippers, wish to have any traffic classed as captive traffic instead of non-captive traffic in order to obtain a maximum rate schedule, a similar application to the Board would have to be made, showing, among other things, that there was no reasonable competition other than rail.

114. In order that there be some relation to

costs in the schedules, it is suggested that the maximum rate schedules be the fully distributed costs as far as could be ascertained. The method used by the railways to obtain total cost for statutory grain movements would be satisfactory. (This standard of maximum rates may bequestioned. If captive traffic is to be carried at no more than fully distributed costs, how can the railways carry competitive traffic at less than full costs? The question may be answered by asking others: What would the railways do if the captive traffic dwindled to nothing because of increasing competition over the next decade or so? Non-regulated competitive businesses in other fields can manage quite well without a corral of captive customers to bear disproportionate overheads and no one could reasonably expect captive traffic - a smaller and smaller proportion of total freight traffic each year - to carry the overhead burden for competitive freight. As an increasing amount of non-competitive traffic becomes subject to competition, the railways will not be able to rely on recovering overheads from this source in the future. It may be pointed out that much competitive traffic now has rates above fully distributed cost; the extent to which this is possible depends on the cost level of the competitors, for example:-

	Rail	Road
Full cost	50¢ per 100 lb.	55¢ per 100 lb.
Rate	55¢ per 100 lb.	55¢ per 100 lb.

115. The classification and tariffs for maximum rates could follow the same form as for minimum rates. It would not be too difficult to combine minima/maxima into one table.

Less-than-carload Schedules.

116. With respect to L.C.L. traffic, it is suggested that actual rate schedules be drawn up by the railways and filed with the Board of Transport Commissioners. The classification ratings should have cost considerations built into them in the same way as the minimum rate classifications. The distance factor would also be the same. To make for simplicity, however, arbitraries for switching, terminal costs, and route could be consolidated. The British Charges Scheme may be looked at for guidance:-

> "The Commission has made it known that scales of charges are to be applied to small consignments and that they will be published for all to see. The agreed charges will, of course, continue subject to review. These scales will reflect the influence of cost and market represented by bulk in relation to weight, by damageability, and by route, in a limited order. This differentiation will be made by simple and straightforward scaling free from complexity or unnecessary refinement. The charges will cover a door-to-door service wherever collection or delivery is normally provided. It will not matter in future whether the traffic is butter or putty;

if it loads well, the charge will be the same. If it loads badly, like Christmas tree decorations, it will cost more, or if it is dangerous or abnormally vulnerable or damageable." (A.A. Harrison "Railway Freight Charges", The Journal of the Institute of Transport, July, 1957, p. 155).

117. The reason why a scale of actual charge is suggested is that out-of-pocket costs are elusive for L.C.L. traffic and the apportionment of overheads would become so arbitrary that little would be lost if the minimum scale became the actual scale. The inclusion of L.C.L. schedules in C.L. schedules is not recommended because L.C.L. commodities have much more in common with each other than with the same commodity in carload quantities. This is because L.C.L. traffic incurs heavy station handling expenses while usually the costs of carload traffic are mainly associated with the line haul. Another reason for separate L.C.L. schedules is given by Mr. G. Lloyd Wilson:-

"It (The Merchandise Traffic Survey of the Section of Transportation Service of the Federal Co-ordinator of Transportation) expressed the opinion that the inclusion of railroad less than carload rates as part of the same rate structure with carload class rates unnecessarily handicaps the railroad carriers in meeting modern conditions of competition, because the class rates application to L.C.L.

shipments cannot be changed without changing the carload rates in the same classes, although changes in the carload rates may be neither necessary nor justified." (G. Lloyd Wilson, "Are Railroad Freight Rate Structures Obsolete?" Harvard Business Review, January, 1935, p. 184.

Passenger Fares.

118. The cost-of-service principle suggests that fares should cover long-run out-of-pocket costs for passengers over each particular route. There is little danger of exploitation of passengers as competition permeates this field, hence there is no need for maximum fare schedules. It is recommended that minimum fare schedules be drawn up by the railways and approved by the Board of Transport Commissioners. Such schedules should segregate routes as far as possible and be based on long-run out-of-pocket costs.

Rate Increases.

119. From time to time the railway companies may require increases in the maximum rate schedules and the Board of Transport Commissioners may wish to order an increase in minimum tariffs to prevent the hauling of unremunerative traffic. General horizontal percentage increases would not be in accordance with the proposed principles of rate-making.

120. It is suggested that changes in the rate schedules should be allowed or ordered if the railways or the Board could show increases in particular costs. For example, if terminal expenses increased because of wage awards to terminal labour, then the terminal

arbitraries would be increased. In this way the costs associated with particular traffic and particular sections of railway working would be passed on to the traffic which incurred the increased costs.

121. Within the minima/maxima it is suggested that the railways be free (as at present) to file and publish individual tariffs as required. Such individual tariffs would cover the entire gamut of the present structure, including the following rates: Specific commodity, mileage commodity, transcontinental, agreed charges, joint, interline, international, export, import, T.O.F.C., competitive, etc.

122. For example, if a railway wished to make an agreed charge, it would simply regard the published tariffs as a minimum and make the agreement as it does now. If the agreed charge did not bring in the same revenue as the minimum tariff, then it would be disallowed by the Board. Any U.S. related rates would be subject to similar treatment - as long as they covered at least long-run out-of-pocket costs they would be allowed; if they were below this level then they would be disallowed.

123. Any increases or reductions in rates within the minima/maxima range would not have to be takento the Board but would simply be filed and published, with notice if necessary. Tariffs and agreed charges should conform to existing rules regarding filing, publication, undue preference, and

discrimination. New agreed charges and renewals of existing ones should be required to carry escalator clauses. This requirement is necessary if railway costs increase and if agreed charges are to be consistent with the cost-of-service rate-making proposals.

124. The recent U.S. Department of Commerce study recognized the advantages of setting maxima/ minima schedules in order to preserve a degree of management freedom:-

> "A critical element in rate freedom is the concept of prices based on costs. At present, too little is known about the relative costs of transporting traffic via the several modes and routes typically available to shippers. A comprehensive study should be made to explore the cost-finding methods most likely to afford proper comparisons between the several forms of transport.
>
> "The effect of such a study cannot be over-emphasized. Improved methods of cost analysis, when applied within a framework of agreed economic standards, will enable the transport industries to set prices and establish services more rationally. Regulatory agencies can then set maximum and minimum criteria rather than specific detailed rates, and the carriers will have the normal managerial initiative of other American enterprises. And the regulated carriers can be equipped to meet the competition of private and exempt transportation where

their cost and service capacities permit". (Federal Transportation Policy and Program, U.S. Department of Commerce, March, 1960, p.9).

Conclusions

125. There has been a tendency in the past to look with alarm at the conglomeration of costs entailed in railway working and to assume that there was no point in carrying out costing operations as a large proportion were overhead. Modern railwaymen, while still believing the job of costing to be difficult, no longer think the task is impossible. Further, they realize that a knowledge of costs is imperative in the light of present and future competitive conditions. The president of the New York Central sounds the call to arms for his colleagues:-

"It is absolutely essential that the American railroad industry roll up its sleeves and make a scientific study of what it costs us to transport freight. When I have said this to some of my colleagues in the railroads they have thrown up their hands at the size and the difficulties of the job, and all are fearful - after the recent divisions cases - that a full knowledge of costs may lead to further changes in divisions. But it seems obvious to me that railroad operations are not so complicated - the production of transportation is not so desperately complex-

that modern cost-accounting techniques and theories cannot be applied to it in order to find out what it costs to move a carload of apples, wheat or coal or anything else from a siding in Michigan to 60th Street on Manhatten Island. And once we get those costs, it does not seem to me to be impossible to build a flexible and practical rate structure around them.

"We need to know our costs. We need to have a consistent pricing system based upon costs." (Alfred E. Perlman, "Scrap This Antiquidated Price Structure" From an address to the Toronto Railway Club, December 1st, 1956. Reprinted in British Transport Review, April, 1957. Op. cit. pp. 341-342.)

Other extracts from this illuminating speech are of interest:-

"Sometimes we do not go out and find out what our costs are, and build rates upon them, because we are afraid of diversions of traffic if we charge what we should. But while we worry about that, and while we fight among ourselves over the interterritorial divisions of rates - fight to get a bigger share of the rates on a smaller share of the traffic - our unregulated competitors, the private and contract carriers, are taking more and more business away from us, so that today they have

more than half of it in their hands.... "The railroads in the United States can cure this evil. We have the power to go out and find out what our costs are. We have the power to build a sensible rate structure based upon those costs, with standby charges built into the rate structure so that a customer's load factor, demand and volume can all be taken into account. Since the days of the wood-burning locomotive we have grasped all that technology could offer us to change our physical plant and have come a long way in adapting new methods to our operations. The operating officer who would try to live today with the old wood-burners would be classed as mentally obsolete. When will we recognize the need for modern thinking to replace our wood-burning rate structure? Regulatory bodies which are charged with the responsibility for the maintenance of adequate and efficient transportation would, I am sure, welcome us with open arms and help us in any needed legislation. For only if we have the will and intelligence to obtain for our industry a rational pricing system can we be strong and efficient". (Ibid., pp. 342, [illegible]).

126. Rate-making which has regard for costs of service has many advantages over present practices. The cost-of-service method of rate-making

as against any other method, will ensure that the railways will get an adequate supply of capital, but no more, relative to their needs, thus providing for future transportation requirements. This will occur because railways will be encouraged to press their competitive advantages on routes where their costs are the lowest and the carriage of unremunerative traffic would hardly be possible. The benefits of special aids, subsidies, grants, modernization, and so on will not be fully realized if a rational pricing policy is not followed. Inefficiency and waste would thereby be eliminated and traffic would be attracted. This view is taken by Mr. George W. Wilson:-

> "National transportation policy seeks to achieve an optimum transport system - that is, the most efficient utilization of existing transport capacity and an assurance that adequate capacity will be made available to serve the needs of an expanding economy....
>
> "From the point of view of obtaining an adequate supply of capital in transportation (a supply neither excessive nor deficient to meet the needs of commerce) it is likewise evident that the cost criterion is required. If rates are based on cost, then freedom of shipper choice will dictate the relative amount of service required from each of the several media which in turn will determine the amount of capital required in transportation and its distribution among rail, truck, pipeline, ships, etc." (George W. Wilson, Needed Changes in Railway Pricing, ICC Practioners'Journal, May 19

127. The conditions of the cost-of-service principle are further expressed by Mr. Nelson:

"The economic gains from providing transport in the most economical way should receive far greater attention than they have in the past. For if the rails adjust their rates in accordance with competitive conditions . . . and in line with their low-cost potentialities, the economy will then enjoy the full advantage of mass utilization of fixed rail facilities and of scale cost economies from use of large freight-carrying vehicles, powerful locomotives, and long and heavy trains. These economies will support lower rates or more rapid modernization of rail plant and equipment through higher capital investment, which in turn will yield lower costs and rates. As in pioneering days, low freight rates, not high ones, are needed for stimulating the fullest development of unexploited resources and the highest volumes of interregional and international trade. But adhering to uneconomic rate relationships -- that were economic only under monopoly conditions -- will deny the country the full advantages of lowest-cost transport, and, in addition, will perpetuate the past disturbing railroad trends.

(James C. Nelson, Railroad Transportation and Public Policy. Washington, D.C. The Brookings Institution

1959, p. 347.)

"In no area of railroading is there more need for a fundamental review of past policies than in pricing. . . . If the roads are to escape from the vicious circle of rising costs, rising rates, lower traffic, rising costs, and so on, they will have to apply pricing policies that can deal successfully with competition by giving users the benefits of the low-cost advantage which mass transport yields when enough traffic is attracted to the rails."

(James C. Nelson, ibid., p. 327.)

128. There is, without doubt, a widespread feeling among knowledgeable transport economists that the adoption of cost as a rate-making standard will rejuvenate the whole railway system. One such writer is Mr. Ponsonby:

" . . . I personally have sufficient confidence in the cost-reducing potentialities of railways in respect of a great range of transport services, to believe that it has only to price the latter on a 'cost plus' basis and it will attract on to rail a sufficient volume of business to enable them to prosper financially and continue in business for many years to come. It is admitted that were such a pricing policy vigorously adopted, much traffic, at present moving by rail, would have to be priced

[illegible]

[illegible]

[illegible]

so high that it would either be 'killed' altogether or carried by other means of transport. But surely from the national point of view, it is desirable that the railways should divest themselves of all traffic at present carried at a loss and so much of which would become economically carried by road. For, once the incubus of carrying certain traffics at a loss were removed, many other traffics could be charged (on a cost basis) at much less than at present. Such traffics would be thereby encouraged and in the long run possibly expand considerably. Thus the railways, by going over to charging more nearly to their real costs of carriage, would come to carry a larger and larger proportion of the kind of traffic which they are best qualified to carry, and less and less of the remainder. Thereby the interests of coordination (functional specialization) would be truly served."

(Gilbert J. Ponsonby, "Towards a New Railway Charges Policy," Journal of the Institute of Transport, September, 1954, pp. 427, 428.)

129. The advantages of rate making as proposed may be summarized:

(a) Better carloading is encouraged as lower charges are based on loadability.

(b) Incentive charges for higher carloadings encourage better use of cars.

(c) Traffic is routed by the lowest-cost routes and through the lowest-cost terminals.

(d) Traffic for which costs are low will be encouraged to return to the railways.

(e) Within the limits imposed by the minima/maxima, the railways would be free to preserve market relationships if it were within their power, and also to preserve existing rate groups.

(f) As there is no maxima proposed for a great deal of traffic, actual rates would be left to the commercial judgment of the railways themselves as a management prerogative. Above the minima it should be entirely up to the railways what charges will be made, subject, of course, to the safeguards against unjust discrimination.

130. Rates within the minimum and maximum limits would be sufficiently flexible to meet new competitive conditions as they arise, thus giving a great deal of freedom to the railways. In this respect the Chief Charges Officer of the British Railways says:

"The negotiating and quoting of rates will call for the exercise of commercial judgment amid many imponderables. The

commercial railwayman of the past and present has been accustomed to knowing more about trade and industry, generally, in relation to transport than most people.

". . . It goes without saying that the new charging procedure must be fast enough and local enough to get the business.

". . . The problem of determining how much net revenue is going to accrue from each action will continue to be difficult but more and more help is on the way as greater refinement of cost information becomes available."

(Harrison, op. cit., p. 155. Professor Clark, writing thirty-seven years ago, did not see that cost-of-service would destroy management prerogatives: "If a system of rates were to be built on the prin-"ciple of cost, would it be so rigid as to hamper "reasonable allowances for commercial considerations? "Not necessarily. In the first place, the principle "of cost requires only that every class of business "covers its own long-run variable costs, leaving "a margin to be collected on the principle of 'what "the traffic will bear.'" (Clark, op, cit., p.290.))

131. A cost-oriented rate-making system is thus seen to break away from traditional practices. The present rate-making techniques, largely disregarding costs, have fostered unsound competition and economic conditions. They have resuuled in the growth of vested interests, which have a stake in the retention

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of the present structure.

132. Should cost-of-service principles of rate-making be accepted, then a change-over from present rates should be fairly gradual in order that serious dislocations can be avoided. As a first step, further equalization of class and commodity scales should be halted. As railway cost studies progressed, maximum scales should be possible for captive traffic. L.C.L. and carload scales could be separated and eventually full minimum schedules could be published. However, the sooner rates come to reflect costs, then the sooner will railways be able to realize their inherent low-cost advantages to the full, and shippers and the community as a whole will be better off.

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APPENDIX B

RATE-MAKING IN EUROPE

133. Several European countries have, in varying degrees, adopted the cost-of-service principle, including Britain, France, Sweden, and Holland.

134. BRITAIN. - The Transport Act of 1953 made changes in railway rate-making, placing emphasis on competition rather than on integration, which had been the intention of the previous 1947 Act. The 1947 Act called for a Charges Scheme and the 1953 Act retained this provision. The Charges Scheme publishes only the maximum charges, leaving the railways free to negotiate the actual rates with each shipper. The Charges Scheme left the British Transport Commission with great freedom to make rates on any principles they wished. The Commission adopted the cost-of-service principle outright, rejecting the existing classification. It has been declared several times that the railways will quote actual rates at not less than the long-run "direct" (out-of-pocket) costs, with the overheads being picked up according to what the traffic will bear.

The Association of British Chambers of Commerce in 1958 put a questionnaire to shippers to find their reactions to the new methods of railway charges. The general opinion was that the Charges Scheme was quite satisfactory. (See Modern Transport, July 5, 1958, p. 9.)

135. Freight-rate making in France and Sweden

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is well described by G. Lloyd Wilson:-

FRANCE. - "The railways of France, encouraged by the Government, have been aggressive in making freight rates in competition with other modes of transportation, including private transportation. The rates on many commodities are published on maximum and minimum basis, with the actual charges on particular shipments made by agreements or contracts between shippers and the railways, based upon competitive conditions and cost of performing the services. The agreements or contracts are submitted to the Minister of Transport for approval but the charges are not made public.

"These special unpublished contract rates are established upon a number of bases designed to meet requirements of individual shippers or to confront particular competitive conditions. Trainload lot freight rates are established on shipments transported in the shippers' or consignees' private freight cars from a fixed origin to a destination point. No switching services are performed by the railways in respect to these shipments. Special reduced rates are made contingent upon the loading of the freight cars to their cubic and weight carrying capacities in order to stimulate the more efficient use of freight cars and to increase the ratio of net weight of cargo to gross weight of the shipments and cars . . . Reduced rates from the same origin points to the same destinations are made, conditioned upon the routes via

which the shipments are transported. Such rates are designed to encourage the movement of traffic via the routes between the points of origin and destination over which operating costs are lower.

"These significant rate patterns are indicative of the trend towards pricing based on cost of service; of pricing to meet competition; and of pricing to promote the co-ordination of transportation by encouraging the movement of freight via the types of carriers and routes which have relative cost and service advantages."

136. SWEDEN. - "The rates are constructed generally so as to produce revenues adequate to cover operating costs, including maintenance, and interest upon investment. Particular rates are constructed to meet the increasing competition of motor transportation. These special rates take the forms of special commodity rates, 'agreed charges' to shippers contracting to ship all or agreed portions of their traffic via the railways; lower rates on multiple carload or trainload lots; zone rates or charges; block rates with rates decreasing per unit as the total volume of freight shipped by individual shippers increases; and in the case of passenger fares, an annual privilege card at a fixed annual charge which gives travellers the privilege of purchasing tickets at half-rates during the period covered by the privilege card, a combination of stand-by charge and reduced charges."

137. HOLLAND - Dutch railways are freed from

the obligation to publish rates. This in turn frees them from the obligation to give equality of treatment to all shippers (as in Britain). Equalization of rates has been abandoned, and different rates per ton or per ton-mile can be charged over different routes. (See Brig.-Gen. Sir H. Osborne Mance, The Journal of the Institute of Transport, May, 1959, p. 122.)

138. OTHER EUROPEAN COUNTRIES. - The Inland Transport Committee of the Economic Commission for Europe have looked closely at costs of inland transport primarily for purposes of uniform accounting and charging practices. The remarks of this Committee, quoted in The Problem of Cost in the Inland Transport Industry, (The Problem of Cost in the Inland Transport Industry, United Nations, 1955.) leave no doubt that movement is towards the cost-of-service principle in European transportation.

" . . . the working party takes the view that a knowledge of the precise costs is essential for the fixing of rational tariffs" (p. 8). "From the community angle, the calculation of transport costs on a uniform bases (sic) is the only means of furnishing the figures essential for the rational establishment of tariffs and for any co-ordination policy, two points which will now be dealt with in greater detail" (p. 7).

"While the experts do not pretend to have found a final solution for all the problems arising out of costing technique, which is still in the empirical stage,

it is impossible to overemphasize the value of their conclusions. These are already of considerable practical significance, since they are immediately applicable in many cases. In their present form, the methods of calculation can be used in particular to analyse and compare the constituent elements of costs for the various modes of transport and they can contribute effectively to the study of certain special problems of the transport industry. The full significance of this statement comes out at a time when serious problems of international scope are exercising the public mind or awaiting decision by governments" (pp. 24,25).

APPENDIX C

Statement of the Honourable R. W. Bonner, Q.C. Attorney-General and Minister of Industrial Development, Trade, and Commerce, to the Royal Commission on Transportation, Victoria, B.C., February 22nd, 1960

I am very pleased on behalf of the Government of British Columbia to welcome the Royal Commission on Transportation to our Province. We appreciate the complexity of the problem you are charged with investigating, and we sincerely hope that your studies and deliberations will contribute measurably to national transportation policy.

I will confine my remarks this morning to some general observations on the terms of reference of the Commission and what the Government of British Columbia considers to be the basic objectives of national transportation policy. As you are aware, our submission will be in two parts. Today we will discuss five major problems:-

(1) The importance of rail transportation to the economy of British Columbia.

(2) The problem of the "Bridge Subsidy."

(3) The one and one-third rule.

(4) The export grain rates.

(5) Other unremunerative services performed by the railways.

At a later date in Ottawa we will make further representations on principles of rate-making, allocation of subsidies, and such other issues within the

terms of reference on which we deem necessary to express an opinion.

I think the members of the Commission are well aware that by the exigencies of geography British Columbia is the most distant Province from the industrial heartland of our nation. Historically the Crown colony of British Columbia would enter Confederation only if a rail link was established with Central Canada. Obviously if British Columbia was to be subject to Canadian tariff laws and excise tax regulations -- cut off from natural markets to the south -- then alternative markets would have to be found in Canada.

British Columbia is a net importer of domestic freight, a good customer of Eastern Canadian manufacturing industry and Prairie agriculture. We must pay for our manufactured goods and food by selling our basic products on the Prairie and Eastern markets. This has been the development of our domestic trading economy. In one sense, economic integration has been the objective of national policy; that is to say, the peripheral regions have been able to participate to a greater or lesser degree in the mass market of Central Canada. B.C. forest products and P.E.I. potatoes have found consistent sales in Ontario and Quebec. To assist the Maritime Provinces, a 20-per-cent subsidy, and recently increased to 30 per cent, on all outgoing freight has been provided by the Federal Government. Although British

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Columbia has had hold-downs in recent years on lumber freight rates to Eastern Canada by virtue of U.S. rail competition, we are finding increasing difficulties in marketing lumber in Eastern Canada.

For example, while there has been a 70-per-cent increase in lumber production between 1948 and 1958 in our Province, shipments to Eastern Canada have only increased by approximately 2½ per cent while the gross value of manufacturing production doubled in Ontario and Quebec between 1944 and 1955. (See R. D. Howland, "Some Regional Aspects of Canada's Economic Development," Royal Commission on Canada's Economic Prospects, 1957.) Our shipments of lumber to the United States have risen recently, but plainly any violent fluctuation in the volatile American market would have serious repurcussions on our economy and that of Canada as a whole.

It is therefore essential for the welfare and growth of British Columbia that we enjoy the widest possible participation in our domestic market. The marketing problems of lumber are duplicated to a greater degree by our fruit and vegetable industry. While our lumber-mills compete mainly with domestic producers in Eastern Canada, our fruit-growers face increasing American competition, particularly in the Prairie markets. Fish from British Columbia travels three times as far as fish from the Maritime Provinces, which is assisted by a 30-per-cent subsidy. In addition,

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in 1957, only 20.6 per cent of our east-bound transcontinental traffic was eligible for the "Bridge Subsidy." In spite of certain competitive advantages on east-bound transcontinental rates, there is a continuous erosion of our Central Canadian markets.

I mention this to illustrate the problem of a "long-haul" Province. The problems of "long-haul" regions are multiplied by horizontal percentage increases. It is a simple mathematic problem that if one shipper pays a $2 rate to a certain market and another shipper pays 50 cents, then a horizontal increase of 10 per cent results in a competitive disadvantage to the first shipper of 15 cents per 100 pounds. It is our contention that national policy demands the freest possible interchange of goods and services, particularly of basic commodities, within Canada. Any other point of view would balkanize Canada economically.

That problem in essence, therefore, is to maintain market relationships within reasonable cost relationships. Our principal basic commodity -- namely, lumber -- should receive the benefit of the lowest possible transportation charge consistent with costs since it is essentially a long-haul, low-cost, high-density movement. Our agricultural production, although it is a small percentage of the total agriculture production of Western Canada, is entitled to the same assistance as other agriculture production in Western Canada.

The fruit and vegetable industry of the Interior of British Columbia, particularly in the Okanagan

Valley, has not enjoyed the same degree of prosperity that other agricultural producers have experienced to a greater or lesser degree in the post-war period. One of the major problems of our fruit industry is the long haul to Prairie and Eastern Canadian markets. We strongly urge the Commission to recommend similar assistance to the fruit and vegetable producers of British Columbia that is enjoyed by the agricultural producers of the Atlantic Provinces and which is proposed for the grain producers of the Prairies.

There has been a tremendous expansion of manufacturing production in Central Canada in the post-war period, protected as it is by our national tariff policies and stimulated by defence spending and paid for by the consumers and taxpayers of the nation. The outer regions are entitled to participate in this mass market. We cannot continue to buy if we do not in turn sell.

To overcome the geographical difficulties which affect the Canadian economy so seriously requires the firm hand of national leadership, having due regard for the changes which are taking place in our regional economies. Certainly as our population increases and a degree of diversification is developed, the need for ingress into Central Canada may become less important. This is, however, not the case today.

National policy must change with the times. What is good for Canada and the Province today may be

inappropriate tomorrow. At this moment in time it is obvious we must rely on our railways as the basic transportation plant of the nation. They are the lowest-cost and most efficient method of moving bulk commodities to market over long distances. Long-distance movement of all basic commodities is fundamental to Canadian economic development, in fact just as fundamental as the grain movement is to the economy of Western Canada. Thus the concept which motivated the creation of the Royal Commission, and I refer to Acting Prime Minister Green's statements of November 26th, 1958:-

> "This study will include not only comprehensive consideration of the railway freight rate problems -- including the situation of the long haul provinces in the West and in the Atlantic region -- but also other specific problems which require solution if Canada's railways are to serve the national interest without prejudicing particular industries or areas, . . . "

must be developed by the Commission because of the fundamental issues involved.

These issues are:-

(1) The rapid development of the most economic and technically efficient rail system.

(2) The elimination of statutory regional discrimination which inhibits west-east movement of commodities.

(3) Relief for such freight traffic which has been

bearing an undue burden as a result of public policy.

(4) The elimination of horizontal percentage increases.

(5) The establishment of the basic costs of rail movement by major commodities and by route.

(6) Compensation to the railways for unremunerative services which are in the public interest.

(7) Co-ordination of transportation services to reduce costs.

I should touch briefly on the problem of "other income." There can be no doubt in anyone's mind that grants to railways were necessary to push forward national development. Moreover, in the post World War II years the Canadian Pacific Railway has done exceedingly well on the proceeds of Crown grants. When we realize the forests of the E. & N. lands are worth over $100,000,000, we can appreciate the dimensions of the problem. The question is should these assets be considered as rail income. In view of the changes in the grain rates which the railways are asking, I think the time has come for a review of other income. The Canadian Pacific Railway was a creature of national policy, and its role is the same today. The national rail systems cannot be separated from the political and economic development of Canada. It may be that the proceeds from land and minerals acquired as a result of national

policies should now be considered as rail income.

I should also like to comment on the disposition of any subsidy recommended by this Commission to the railways for losses on the movement of export grain or any other unremunerative service.

We have heard the propositions of the C.P.R. and C.N.R. that a subsidy be paid into the general revenue of the railways. In short, the railways would be the immediate beneficiaries of the largesse from the public purse -- the taxpayers' pocket. What about the shipper who has paid round after round of percentage increases -- watching the erosion of his distant markets -- because of losses suffered by the railways due to public policy or managerial indiscretion?

The Province of British Columbia believes that any subsidy recommended or awarded must take into consideration the "captive" shipper primarily and the "long-haul" shipper who has some competitive advantage. Only thus will the full intent of the terms of reference be fulfilled.

We insist most emphatically that if a subsidy is recommended by this Commission to compensate the railways for work done in the public interest, then the shippers who have borne an undue burden of freight rates due to the aforementioned losses must receive a downward adjustment in rates.

Before closing I would like to say something in respect to the Pacific Great Eastern Railway, owned and operated by the people of British Columbia. For

many years this railway was held up to ridicule by other railways in Canada as one which started nowhere and ended nowhere. Today it has become an integral part of the rail system of Canada, connecting with the two major Canadian and three American lines at its southern terminal, with the Canadian National at Prince George and the Northern Alberta Railway at Dawson Creek.

This railway serves the vast Central Interior of our Province, famous for cattle-raising, lumber, and mining, and the grain-farming area of the Peace River District, the centre also of the rapidly developing petroleum industry of North-eastern British Columbia. Not only has the extension of this railway built on the credit of the people of British Columbia, given a great impetus to the economy of this Province, but I think the following table will convince you that it has been a great benefit to the other railways of Canada:-

PACIFIC GREAT EASTERN RAILWAY

Loads Delivered to Connections

	North Vancouver (C.N.R.)	Prince George (C.N.R.)	Vancouver (C.P.R. and G.N.R.)	Dawson Creek (N.A.R.)	Total to Connections
1959	1,785	13,807	8,474	264	32,245
1958	4,319	6,378	8,545	7	25,141
1957	2,244	5,783	8,440	-	18,843
1956	-	9,534	13,322	-	22,856
1955	-	8,077	12,098	-	20,175

Loads Received from Connections

	North Vancouver (C.N.R.)	Prince George (C.N.R.)	Vancouver (C.P.R. and G.N.R.	Dawson Creek (N.A.R.)	Total from Connections
1959	1,711	836	3,933	552	7,040
1958	1,417	843	4,950	18	7,238
1957	2,538	678	5,479	-	8,695
1956	77	997	11,361	-	12,732
1955	-	399	7,089	-	7,488

Source: P.G.E. Traffic Department.

The bulk of the traffic originating on the Pacific Great Eastern is forest products destined for the United States, Eastern Canada, and some to the Prairie Provinces. This is all long-haul and lucrative traffic for the Canadian National and the Canadian Pacific Railways.

If a Federal subsidy is to be granted to the railways in order to assist the movement of traffic, the

Government of British Columbia is of the opinion that the P.G.E. is entitled to share in that subsidy on an equal footing with the C.P.R. and the C.N.R. This should be the case whether the subsidy is granted for specific commodities and movements or for any other purposes, such as unremunerative services or a general reduction of rates.

I have endeavoured by these informal remarks to indicate the lines of thought to be developed by our counsel for the consideration of the Commission. I hope most sincerely that our submissions will prove to be helpful. All facilities of the Provincial Government are available to assist your Commission in its studies. May I assure you that your presence in British Columbia is warmly welcomed by all in the Province.

MR. BRAZIER: There is one further thing I think I should probably mention, Mr. Chairman, before Mr. Cooper starts his cross-examination. You can appreciate the fact that if the principles which we are advocating in our brief should be adopted by the Commission and subsequently by the Government, that it would require substantial amendments to the Railway Act as it now stands; and it is my intention at a not too distant date to submit to the Commission the amendments to the Legislation which I think will be necessary in order to implement this particular principle.

THE CHAIRMAN: We would like that. Mr. Cooper.

CROSS-EXAMINATION BY MR. COOPER:

Q. Mr. Hughes, I am going to refer in my examination to the submission rather than to the transcript, because I think it would be easier to follow the questions that way and easier for everybody concerned, and I see you have a copy of the submission before you.

I should like to refer you first, Mr. Hughes, to page 7 of the Submission and to the following sentence which occurs at the top of the second column on the page No. 7.

THE CHAIRMAN: Part I.

MR. COOPER: Q. Part I.

"The prosperity of the manufacturing industries

"and urban centres heavily depend on the
"prosperity of the primary industries, and
"it is the fundamental concern of this
"Submission that the economic health of the
"Province be not weakened by reason of high
"or unreasonable freight rates."

Do you consider, Mr. Hughes, that the economic health of the Province is now suffering because of unreasonable freight rates, or is the concern of the Province at what may happen in the future?

A. If I can get to your answer in a roundabout way, the primary industries, of course, in British Columbia are by far the most important ones. In Figure 1, on page 11, we have a good example there of our primary products.

In another little book here that I have we did a study in British Columbia, or some people did a study in British Columbia called "Manufacturing Industries in the Lower Mainland of British Columbia" and it tells just what we do there.

Q. Who is the author of that book?

A. Let me get the correct title, "The Lower Mainland Regional Planning Board of British Columbia" and this is dated January, 1960.

THE CHAIRMAN: That is a Government publication?

A. No, it is not really a Government publication. The Lower Mainland Regional Planning Board is mainly to do with Municipal Government, it is nothing

to do with the Province of British Columbia, it is Municipal Government.

MR. COOPER: Q. It is a voluntary organization of those interested in promoting the members of the Lower Mainland region?

A. No, it is not a trade association, they are not private individuals. They are employed by this Association, but it is more of local government, however, and it is not a trade association like a Board of Trade.

Q. It is an association of local government officials?

A. That is right, yes.

THE CHAIRMAN: It is a public body.

A. Public body of all the municipalities in the Lower Mainland. In this we have a diagram, and I have worked out the figures from it and its talks about employment and it gives the percentage of manufacturing employment.

MR. COOPER: At what page is that diagram, Mr. Hughes?

A. This is Table I, page 5 in Roman Numerals.

MR. COOPER: Perhaps, Mr. Brazier, we could have a copy of that document filed for the purposes of the Commission.

MR. BRAZIER: Yes, we will be very pleased to.

THE WITNESS: For wood products as a percentage of all manufacturing employment, 32 per cent of

people were employed in wood products.

MR. McDONALD: What page is that?

THE WITNESS: Table I, page 5.

MR. COOPER: It is in a different book.

COMMISSIONER ANSCOMB: Not in the brief.

THE WITNESS: No. Food and beverages, 20 per cent; metal products, 17 per cent; printing and miscellaneous, 8 per cent; transportation equipment, 6 per cent. We get there 83 per cent of the employment of the Lower Mainland of the region, but throughout Chapter 1 it is obvious, I think, from Table I as an example, that most of our economy is dependent on those primary industries. In Table I you see in the last column which is 1959, 4.4 per cent of the value of production in British Columbia was in agriculture, forestry 15.6 per cent, fisheries 1.8 per cent, mining 4.8 per cent, electric power 4.3.

The manufactures -- and I have just said that manufactures are mainly primary manufactures -- 43.9 per cent; construction 25.2 per cent.

So we are very heavily dependent upon these primary industries. We are dependent on the primary industries and the manufactures that come from those primary industries such as saw mills, fish canning; We are now getting into making fruit juice and this cider, so we are very specialized on a very narrow base. We are mainly specialized for forestry, we are specialized on fishing, we are specialized in agriculture such as apples, peaches and soft fruits.

Because we are specialized, it means we have to reach out to different markets because if we do not reach out to different markets, then we would all be eating our own apples all the time, we would all be trying to use all our own plywood and all our own lumber. It would be just taking in each other's washing. We have to reach out, and that is why freight rates are of such importance to an economy which is not very highly diversified.

If we were diversified, then we could trade with each other around the area for the things we wanted and the things that we had surplus ourselves.

Q. You consider that these primary industries or occupations in primary fields in British Columbia are presently suffering from high or unreasonable freight rates or, as I said before, is it that you have concern rather for the future?

A. Yes, I think they are. I cannot at the moment think of any industry or any firm that is actually going bankrupt now, but I have no doubt that there are many who are pretty hard up right now because, you know, we have taken a very great drop in lumber prices. Housing construction is going down, but whether this is primarily related to freight rates or not, it takes a better man than I to say, because it may be housing starts coupled with the high freight rates on lumber, for example, rather than to pin them down on high freight rates.

So there is no doubt about it that we could

suffer from high freight rates by having to reach these high markets and especially as our traffic is non-competitive for a very great part. Then as the railways get more and more competitive, then the freight rates will be put more and more on us, and there is no question at all that we would suffer if we were not specially protected in some way.

COMMISSIONER MANN: Mr. Hughes, earlier, I think, unless I was mistaken, you referred to food and beverages as a primary industry. Now, when you say that you do not mean just in the accepted economic sense?

A. No, if I said it was a primary industry, I should not have done. I was putting out the manufacturing employment in British Columbia to show that most of it was primary and mainly of wood products. I did not mean to say food and beverages was primary.

COMMISSIONER MANN: Food and beverages, that sector includes, I suppose, bottled beverages and baking of bread and so on which are typical local industries?

THE WITNESS: Yes.

COMMISSIONER MANN: Where freight rates perhaps would not be so important.

THE WITNESS: Well, they are there because the freight rates are important, many of them are. We would ship all our beer in from probably some firm in Montreal if it was not for the high cost of carrying beer to British Columbia.

COMMISSIONER MANN: You would not bring any grain from Montreal.

COMMISSIONER ANSCOMB: Do not get any foolish

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

idea like that.

THE WITNESS: Sorry, we will keep it to Coca-Cola.

COMMISSIONER ANSCOMB: Liquor Boards just don't do it, that is all. Don't kid yourself. Even if the freight rates were a little better on it, no province does that.

THE WITNESS: I beg your pardon. That is the kind of thing I mean, that some of these industries would not be there if it was not for the high freight rates, some of them; but bread, of course, it would be stale by the time it would get to us from Montreal or Toronto or anywhere else.

THE CHAIRMAN: Are you complaining of the present condition, or is this something in the future?

THE WITNESS: This is the present condition, that we have very high freight rates, but we are frightened that they may go even higher as the railways become more competitive and start looking around for some place else on which to put a freight rate increase.

MR. COOPER Q: Under the present conditions you say you have unreasonable freight rates. I notice in the paragraph here you speak of them as being high or unreasonable. You have just said that presently you consider that British Columbia has high freight rates. Would you say that presently British Columbia has unreasonable freight rates?

A. No, I would not say they were unreasonable, otherwise we would have gone to the Board and they could have done something about it, but I am frightened -- by "unreasonable" I really mean high freight rates and unreasonable in relation to the cost of carrying the products.

THE CHAIRMAN: Do you mean unreasonably high or low? Mr. Frawley might have some ideas ...

THE WITNESS: I think they are extremely high -- that is, the charges that we pay -- and it is the future I am really thinking about here with our traffic remaining non competitive.

MR. COOPER Q: That is all I wanted to

establish, and I think you have now said that it is the future you are concerned with, and not the present.

A. That is the main thing, yes.

Q. Will you turn to Table III on page 8? That is a table showing the value of shipments, manufacturing industries, British Columbia 1957. I notice in the industrial group "petroleum coal" the figure is 149,097 -- that is in thousands of dollars -- and the percentage figure is 8.2. The same figures appear lower down as the figures for "products of petroleum". Is there some repetition there, or did someone make a mistake?

A. Yes, this is a mistake, and I think -- well, I do not know, but I think "petroleum coal" should go out. It is petroleum and coal, really. "Petroleum coal" should be taken out. I have not re-calculated the percentages since I have realized this, but I can let you have them this afternoon.

Q. Thank you. Table V shows the major items purchased outside the region by manufacturing firms in the lower mainland of British Columbia, 1957, and then under "source and type of commodity" is shown "eastern Canada", and I believe that there are fifty-four items shown in that column. How many of these fifty-four major items move from eastern Canada under agreed charges?

A. It is very hard to tell, really, because the charges are really more specific than this. For instance, "hardware" covers many items.

But, we think all but about eighteen are under agreed charges.

Q. All but eighteen?

A. Yes, all but eighteen are under agreed charges.

Q. You said earlier, Mr. Hughes, if I remember correctly, that the majority of traffic moving out of British Columbia and, I believe, also moving in, moves under rates which are not competitive rates. What are the percentages of competitive traffic against non-competitive traffic going out of British Columbia, and coming in? Those figures may be in a table here, and if they are perhaps you would tell me which one?

A. They are in some table which I shall have to look for. The figures, unless I have them broken down elsewhere, and I do not think I have, would be in Table VI-C, class rates; Table VI-D, non-competitive commodity rates; Table VI-E, commodity competitive rates; Table VI-F, agreed charges; and Table VI-G, mixed shipments. Do you want me to calculate them for you now?

Q. No, you need not do them right now.

A. The figures are here ---

Q. Yes, the figures are there, but perhaps you might put in a figure representing your calculation later on?

A. Yes.

Q. Would you turn to Figure I on page 1[illegible]. I have had some difficulty in following this Figure I, possibly due to poor eyesight. Therefore, I

would like to follow some of the products mentioned with you so that the Commission can understand the purport of Figure 1, and so that I also can understand exactly what is meant by it. Now, if we take "plywood and veneers" first, I understand that plywood and veneers are sold outside the province to the prairie provinces, eastern Canada and abroad only, and that there are no sales to the United States? Is that correct according to the dottings and the cross-hatchings there?

A. Yes, that is correct.

Q. Take sawmill products which, I understand, is lumber and shingles; sawmill products are sold outside the province to the prairie provinces, and then we have a small rectangle there which represents eastern Canada, does it?

A. Yes, eastern Canada.

Q. And then the United States?

A. Yes, the United States is the large block.

Q. Yes, and abroad?

A. Yes.

Q. What percentage of the total sales of the sawmill products are made in eastern Canada? I presume that can be calculated from the figures, but have you got a figure for the percentage?

A. Yes. The source of this -- I did not get the table, but I have been able to calculate it approximately for some of the products. There was a total value of $140 million. The sales

outside British Columbia to the prairies are 2 per cent; to eastern Canada, 2 per cent; to the United States 50 per cent; and offshore 14 per cent, making a total of 68 per cent on our products sold outside the province.

Q. Have sales to the United States decreased or increased in recent years? What is the trend in the export of sawmill products?

A. They have certainly increased in the last few years, but I think -- we just do not know what is going to happen tomorrow. They sometimes go up and sometimes go down, and I think right now we are in a pretty tight spot.

Q. You have spoken of eastern Canada with respect to Figure I. I want to ask you what area is represented by those words "eastern Canada" in Table V. Is that everything east of the prairies, or what?

A. This is outside British Columbia. "Eastern Canada" means "outside of British Columbia", according to the man who compiled this table.

THE CHAIRMAN: It includes Alberta and Saskatchewan?

MR. COOPER Q: So, in Table V would you say that "eastern Canada" comprises everything east of the Rockies?

A. Yes.

Q. And in Figure I -- well, of course, in Figure I "eastern Canada" would be everything east of the prairies.

THE CHAIRMAN: Now we know what is east and what is west.

MR. BRAZIER: There is just British Columbia and eastern Canada.

MR. COOPER: I always thought it was Cape Breton and Canada.

Q. Now, will you turn to Table VIII and look at that for the moment. That table is headed "Car load freight; railway freight traffic in British Columbia by major commodity groups for selected years 1950 - 1954 - 1958". This table indicates marked increases in loadings at stations in British Columbia from 1950 to 1958 in the forest, manufacturing and miscellaneous commodity groups. If you look at the forest group, for example, you will see that in 1950 the figure is 3,272,306, and that has increased in 1958 to 5,423,330, and there has been also an increase in the manufacturing and miscellaneous commodity groups. Would it be fair, Mr. Hughes, to infer from these increases that freight rates have not held down industrial progress in British Columbia in the two most important areas of industrial activity in that province?

A. I do not think it would be fair to imply that for this reason -- the growth here from 1950 to 1958 is over a period of 8 years, and we have had a lot of things happen in British Columbia in eight years. We have had increased population, a general increase in the gross

national product -- all kinds of things besides freight rates. It would take an awful knock in the gross national product and in building in Canada to put these figures in any other way. You cannot single out freight rates and say that there is the difficulty, but I think we could say that if freight rates had been higher then probably we would not have had the same kind of growth.

Q. What you say is that there are so many factors which might have given rise to this increase that you cannot direct your attention specifically to freight rates, and you cannot give me a clear answer on that one specific item; is that right?

A. Yes, that is right.

Q. At any rate, there has been a marked increase in loadings at British Columbia stations in those two products; there is no doubt about that?

A. There is no doubt about that, yes.

Q. I want to swing back, if I may, to Table V. You have said that the quantities mentioned there under the heading "eastern Canada" move at agreed charges except, I think you said, for eighteen of them?

A. Yes.

Q. How many of these eighteen commodities which do not move under agreed charges move under trans-continental competitive rates from eastern

Canada? Do you know that?

A. I cannot tell you right now, and, in fact, it would be very hard to tell you at all, but we will try and see if we can sort out these products. The way the tariffs are lined up, they get very specific sometimes, and you cannot tell from these general things, but we will do our best.

Q. Thank you. To come back again to Table VIII, I notice there a small point, and perhaps you can clear it up. There has been a marked increase in unloadings at stations in British Columbia of agricultural products. As between 1954 and 1958 it is a very marked increase. Can you give us an explanation for this increase? For example, the 1950 figure for unloadings at stations in British Columbia is 669,831, and in 1958 it is 5,414,100.

A. Well, the reason for it there is that it is not a mistake in the table, but they did not start putting statutory grain into these figures until 1956. If you would like the statutory grain figures to make them comparable, we have them here.

Q. Perhaps we had better have them.

A. Yes. The 1950 statutory grain is 1,884,071 tons, and the 1954 figure is 3,475,246 tons.

Q. I notice the source of this table is the annual summary of railway freight traffic,

Dominion Bureau of Statistics, and what you are saying, as I understand it, is that the D.B.S. figures, prior to 1956 did not include statutory grain unloaded at stations in British Columbia?

A. That is correct.

COMMISSIONER MANN: There is a figure of 1,884,071 shown to have been delivered to foreign connections in the next column?

THE WITNESS: That is right.

COMMISSIONER MANN: And the same holds true for unloadings in 1954?

THE WITNESS: Yes.

COMMISSIONER MANN: If you turn your eye over to the next column you will see it there?

THE WITNESS: Yes. I am giving them now to make the figures comparable, and so that you can see the difference in 1958.

THE CHAIRMAN: Even considering that this is a tremendous increase.

MR. COOPER : Yes, Mr. Chairman.

Q. Would you turn now to Table IX? This table, as I understand it, is derived from Table X; is that correct?

A. That is right, yes.

Q. Table IX does not take into account, in the revenue column, the lengths of haul. Have you calculated the revenue in cents per ton per mile so that the Commission will have this information? That is what I would like to have. Is there a third column there for revenue in cents per ton per

mile? I have the figures here and perhaps I could give them to you, and perhaps you could check them and see if they are right.

A. Yes.

Q. British Columbia, 1.65?

A. You realize that I am not very interested in these figures. I will just make a note of them.

THE CHAIRMAN: But we are.

MR. COOPER Q: Yes, the Commission may be interested in them. British Columbia, 1.65; Prince Edward Island, 1.49; Alberta, 1.83; Saskatchewan, 1.78; Manitoba, 2.10; Quebec, 2.43; Ontario, 2.07; New Brunswick, 1.71; Newfoundland, 3.43; Nova Scotia, 1.21; Canada, 1.93.

MR. SINCLAIR: Does that mean, Mr. Cooper, from the figures you have just given, that it is only Ontario, Quebec and Newfoundland that are over the Canadian average?

MR. MAURO: And Manitoba, as always. The Manitoba figure is 2.10. It is higher than Ontario.

MR. SINCLAIR: Yes, but lower than Quebec.

THE CHAIRMAN: What is this, now?

MR. COOPER: The heading of that column will be "revenue in cents per ton per mile".

MR. BRAZIER: This is really dividing, for instance, British Columbia's figure of 739 into $12.2?

MR. COOPER: That is right, Mr. Brazier.

Q. Mr. Hughes, you have said that you are not interested at all in that column. Would

you indicate to the Commission why you have no interest in those figures?

A. Well, the shipper in British Columbia -- after all, British Columbia is here representing the shippers and the receivers. They probably have not heard of a ton mile. I will have to start talking to university students and telling them what a cent per ton mile is. A lot of shippers do not know what you are talking about when you mention cents per ton mile. What they understand is what they see in the tariff, namely, so much per 100 lbs. from Vancouver to Toronto. They are looking at the 100 lbs., and they charge per ton. It matters a great deal to a man when he is selling lumber, say, in Toronto and it costs him $31 or $32 to get it there and he is only getting $60 or $70 at the mill. He is not worried about these statistics which may be interesting to D.B.S. or the railways if they are doing any studies of their own. They are certainly of no interest to a shipper when he looks at his tariff.

(Page 13437 follows)

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THE CHAIRMAN: But there are shippers in other provinces, too.

THE WITNESS: I am sure if you speak to most shippers, they don't know what a ton-mile is. Not most shippers but many of them think in terms of the total charge which is made for the total transportation of their product.

MR. COOPER: Q. In other words, Mr. Hughes, you are only interested in the charge per ton which the British Columbia shipper has to pay, whether that is high or not, without regard to the distances products have to travel compared to the distances of the shorter haul people.

A. Yes. British Columbia people would be delighted with higher rate per ton-mile if they could get their products into the market at a low total charge.

Q. Well, in fact, you are not concerned with the distance as such in this Table IX, and I think the same applies to other tables in your submission.

A. Yes. Rates per ton-mile have no relevance at all when you are trying to put products into the market, and that is why I excluded them.

THE CHAIRMAN: You understand we are concerned as a Commission with inequities.

THE WITNESS: Well, it seems to me, Mr. Chairman, that these are interesting statistics on the rates per ton-mile, but if you are looking at inequities you are looking at people trying to get products into

the market and paying more on their freight bill. This has no interest to the shipper; he is trying to get his products into the market.

THE CHAIRMAN: I am just trying to get your idea.

MR. COOPER: Q. As the Chairman has pointed out, what the Commission is interested in is inequities in the freight rate structure. Now, in these rates in British Columbia — or, rather, I should say in the average revenue per ton, British Columbia, in Table IX it is 12.2 dollars. Are you maintaining that that indicates an inequity in the freight rate structure as far as British Columbia is concerned?

A. No, I am not saying that. I am saying that this is the cost for being a long way from the market. I am not saying it is an inequity in the structure in the brief here. There are good reasons for it being so high, but I am saying that it might be more because it is giving the railway -- I don't know if they are making a fantastic profit or losing money or not. We are not saying it is an inequity until we know the facts.

Q. On Table X, are there any reasons why a class-rated traffic is not included in this table? That would also include Table IX.

A. There is a reason for it. It is such a small part of the total. Table X and Table IX are weighted averages, and to include the class rates it

would have meant a lot of calculation and it would not have influenced it at all.

Q. If you had included the class rates you consider there would be no significant changes to be made.

A. I am quite sure that would be the case.

Q. Would you look at Tables X A and X B?

COMMISSIONER GOBEIL: You haven't looked at Table IX A here. What is the difference between IX A and IX?

MR. COOPER: One is by origin and the other by destination, I believe, Mr. Commissioner.

Q. Now, I was directing your attention to Tables X A and B, and these tables show the distance and cost characteristic of various commodity groupings under agreed charges. It appears in the commodity group of animal products that British Columbia has significantly lower rates than Ontario, and the average length of haul are very close. What is the explanation for the difference? In Table X A, for example, animal products under BC are 39.9, under Ontario 52.2. In Table X B, average haul per ton, British Columbia, 2,692.3; Ontario, 2,393.4 -- very close.

A. Yes. I can only really speculate on this, because you can't really get behind the waybill analysis. But it looks to me that Ontario are shipping a great deal more processed meat, probably higher valued

meat than, say, cut meat or dressed meat or just low-valued canned meat. These were the statistics as we got them, and I think it is a difference in the value of the product which probably makes a difference in the freight rate.

Q. What you are saying is that Ontario must be shipping a class of products which are probably higher in value?

A. Yes, I think that is the difference.

Q. But the table is correct as far as the figures are concerned?

A. Yes.

Q. Table XI shows average freight charge per ton by rate group, by originating province, 1957. In the compilation of this table, length of haul has not been taken into consideration. Now, perhaps we have touched on this subject before, but should not length of haul be considered in order to obtain a true comparison?

A. I don't think so. As I say all the way through the brief, some of our markets are very competitive markets, and whatever the selling price is in the market, the man has to take his freight charge into account; say, the price at the mill or the packing plant. I think it is the charges per ton which are significant. If the rates per ton-mile were equal, then, of course, British Columbia would not be there.

Q. This merely points up what you said before, that this submission is not primarily concerned

[illegible]

with comparisons with other provinces in their freight rates but merely with whether British Columbia has high rates affecting the ability of British Columbia shippers to get into competitive markets.

A. Yes. We have high charges.

THE CHAIRMAN: We will adjourn for five minutes.

---A short recess.

MR. COOPER: Q. Mr. Hughes, may I direct your attention to page 21, the second column, the two sentences which read as follows:

"The ability to reach world markets as cheaply
"as possible is of concern not only to the
"province but to Canada as a whole. In moving
"goods to foreign markets freight charges
"by rail are important as ocean shipping rates
"are closely competitive with rail rates."

I don't quite understand those two sentences. Would you comment on them, please?

A. The second sentence:

"In moving goods to foreign markets freight
"charges by rail are important as ocean
"shipping rates are closely competitive with
"rail rates" ---

I wish you would delete it, because when I am reading it over again, it doesn't seem to -- it shouldn't be there. Either deleted or -- I don't know what you can do with it.

Q. Or disregard it?

A. Ignore it.

Q. You have set out in Table XII the market changes in the United Kingdom market with respect to lumber, and on page 22 you say in the first column on that page:

"Table XII indicates that in the United "Kingdom market in the period 1953/54 to "1957/58 Canada has lost exports of one-quarter "billion board feet while Russia, Finland "and Norway gained substantially in this "growing market."

Are the losses in the U.K. primarily due to increased costs of production, or what are the reasons for the loss of so much of the U.K. market by British Columbia?

A. Well, the reasons are very complex, and the lumber markets in the U.K. -- I am just afraid I don't know really enough about it to be able to help you very much. But I know there have been currency restrictions there. I know that in some of the Russian trading agreements, I believe -- I am not too sure -- I believe they have it written into a trading agreement that they will meet any prices. Factors such as increased cost of production -- I don't know if it has had any effect. I think they do their best to meet the world price. There may be something in there. As I say, I am not an expert on this particular market.

COMMISSIONER ANSCOMB: The last two words, "growing market", mean that the consumption of lumber is growing heavily in Great Britain, the use of lumber.

THE WITNESS: Yes. The total market change in this table, at the bottom of Table XII, total market change plus 31,345. Now, this is a growing market in these years, and I believe it is still growing in the boom they have in Britain. They have a very good time now in the gross national product per head.

MR. COOPER: Q. Do you know if these losses in the United Kingdom market have continued through 1959?

A. No, I don't have the figures. But I think the absolute figures were fairly good; but again I think that probably the other countries also had quite a good time in 1959. But we will have a look and see if we can get the proper figures for you.

Q. The significance of this table in so far as your submission is concerned is that with the loss of such a substantial portion of the U.K. market British Columbia is more and more dependent upon the home markets, and therefore the matter of freight rates in getting into the home markets assumes greater importance than that matter has had in the past.

A. Yes. As we try to get into these very competitive markets and get into the trading blocs, which is a very tough thing to do, then we need some

market -- not really a guaranteed home market, but some good home market in order that we can take these knocks in the foreign markets.

Q. Although your market in the United Kingdom is increasing.

A. Yes, up to last week. I think the bottom has dropped out of it in the last week. But I would have to make some statistics to put it before you in some statistical form.

Q. Now, on page 22, you say in the second column there, the second complete paragraph:

"The railways were constructed in uneconomic
"locations and became instruments of national
"policy."

Now, we have run across this phrase, "instruments of national policy", on a number of occasions in previous submissions and in previous evidence, and I should appreciate it, Mr. Hughes, if you would define for the benefit of the Commission what you mean exactly by the phrase "an instrument of national policy".

A. Well, now, then, I can answer it like this. As I have said in the brief here, they became instruments of national policy. I am basing my reasoning there primarily on what is said in the Turgeon Report, when at page 275 he talks about national transportation policy, he talks about the construction of the Inter-Colonial, the Canadian Pacific, Newfoundland, Prince Edward Island, and he talks about

these as instruments of national transportation policy; and also in Henry you will see the quotation on the same page. I wouldn't like to go beyond this. This is what I mean by national policy in the past.

Q. What about the present? Do you think that the railways have remained and are today instruments of national policy?

A. Well, now, railways -- we do know that the Canadian Pacific had its location shifted to where the gradients were higher; we know it would have been better to build it through the United States, and if we had not that national policy in the past, we possibly may have had some benefits now. As far as national policy in the railways today is concerned, I can see that railways are instruments of national policy in the Crow's Nest rates, the Maritime freight rates and Newfoundland, and possibly other areas, and these are all mentioned in the report.

Q. If I understand you correctly, the only way you consider this phrase "instruments of national policy" can be defined is to point to specific instances where national policy has been advanced through the instrumentality of the railroads.

A. That is right. I would just look at Turgeon and fully agree, I think, that these are the instances, and taking them all together, then this has been national policy in the railroad business.

THE CHAIRMAN: Would you argue from that, Mr. Hughes, that, using your term, "The railways were

constructed in uneconomic locations", there should be abandonment of the railway in these uneconomic locations?

THE WITNESS: No, I don't -- that would, of course, be a very good reason why this has happened. I certainly wouldn't want an abandonment of the Inter-Colonial line because it is in an uneconomic location, for example, but I should really have to think about that. I think the whole tenor of the brief is that if it is national policy, even if it is losing money, then some steps should be taken to keep it there.

MR. COOPER: Q. Were you thinking particularly of branch lines there?

A. No. When I am talking about railways as instruments of national policy, I think here I was talking about the whole situation, the C.P.R., the Newfoundland Railway, and things like that. I wasn't thinking specifically of branch lines in this particular bit.

Q. Perhaps the Chairman may have touched on this point, but I should like to put this question to you.

To what extent, if any, should the financial needs of the railways be subordinated to their use as instruments of national policy?

THE CHAIRMAN: Which is the very vital question.

MR. COOPER: Well, I think so, Mr. Chairman; I hope so.

THE WITNESS: I shouldn't think that the

railways and, by the same token, the freight shippers, should be burdened by national policy. But what I think in this matter – and this is probably not what the Parliamentarians think, the Government thinks; this is my opinion -- I don't think that the freight shippers or the railways -- and, of course, it never was proved that they are burdened or anything else -- I don't think they should be burdened by national policy.

Q. Then you don't think that the financial needs of the railways should be subordinated at all to their use as instruments of national policy; their financial needs should come first. Now, if they are used as instruments of national policy, and thereby their financial position is weakened, then the amounts by which they have suffered should be made up by money from government sources. Is that what you are saying?

A. That is what I am saying, but I want to make it clear now that I do not know if the railways are suffering, and I am not a financial expert. This is a sort of hypothetical question, if the railways are suffering. I don't know whether they are suffering, but if it were proved that they were suffering and also freight shippers were suffering, then I think they should get something first - or they should not be put after national policy; the freight shippers and the railways should not bear burden of national policy, that is what I am saying.

Q. Would it be correct to say that it is national policy itself in this country to have financially sound railways?

A. Yes, certainly, I would say that.

Q. May I direct your attention to your Figure 2 there on page 23. You show there population in thousands and distances from Vancouver, Canadian prairies and U.S.A. Pacific coast (towns over 50,000 population). Now, would you look at the 300 mile arc there. Now, if you completed the circle of which that arc is a part, what would be the population figures within that 300 mile area be excluding the 984.9 figure there shown? In other words, what is the population of other parts of British Columbia within a 300 mile radius of Vancouver, and also the population of the Greater Vancouver area?

A. If we take it on the same basis as

this table, is that what you want?

Q. Take it that way first.

A. Well, I think in 1951 - and these are 1951 figures, the census figures - I think but I am not sure, that the population of Vancouver was around 600,000.

Q. Substantially over that now?

A. I had better check that from the Canada Year Book. I know it is 738,000 now.

Q. Perhaps we could put that figure in the circle.

A. In the circle, Vancouver --

Q. Vancouver circle.

A. Going east from Vancouver in the 300 mile circle there are no towns over 50,000.

Q. Are there any towns over 50,000 within a 300 mile radius?

A. Going over to Victoria there is 125,000 I think, 125,000 in Greater Victoria.

Q. What about areas where the population is less than 50,000 in towns.

A. By the way, in the circle there, when I said this figure is about 600,000 in the greater Vancouver area, the whole - which goes pretty well down to the border ---

Q. That is the figure which you said later is 738,000.

A. That goes about to the border. Going east we have about, in 1951, I should say, 175 or 80,000 in the Okanagan.

Q. 175 - 80,000?

A. Yes, in the total area around Vancouver 300 miles I would say that it would have been about 800,000 population as of this date.

Q. That does not include the 738,000?

A. Including that.

Q. Including that now 738,000 as greater Vancouver?

A. No, we are getting on a little different basis. I am talking about 1951 when I said 600,000 of greater Vancouver.

Q. I am sorry.

A. This is down to the border. Then continuing the arc of 300 miles around Vancouver.

Q. In 1951 figures about how many?

A. 600,000 in greater Vancouver. The whole area about 800,000. I will get you the precise figures as soon as I get the population statistics.

Q. For years later than 1951, in fact up to date?

A. No, I cannot do that because the census is once every ten years.

Q. Whatever the latest census figures are.

A. Yes.

Q. In Table 14, the rail figures in this table include intra-provincial movements, as I understand it, is that correct?

A. Yes.

Q. Are they made up on the same basis as the tables on page 17, so that the incoming in Table 14 is the equivalent of the unloaded in British Columbia in Table 8, and the outgoing the equivalent of loaded in British Columbia in Table 8, except, of course, that I recognize that they are for different years?

A. Yes, they are the same basis.

Q. Now, I come to page 24, and I direct your attention to the paragraph immediately under the heading "British Columbia's dependence on rail".

> "Shipments from British Columbia, being bulky, heavy, and travelling long distances, are ideally suited to rail and are in many cases tied to railways as there is no reasonably competitive form of transportation for these types of commodities."

Is water shipment reasonably competitive to any significant degree? You might tell the Commission what water services there are from British Columbia. Let us put it this way, water services to points on the western coast of the United States and water services to the Atlantic seaboard.

A. Yes. Of course, we have really not very much water transportation of lumber around eastern Canada. It gets about as far as New York.

Q. Is there a significant movement by water to New York?

A. Yes, and how significant I cannot tell you. I would have to look at some statistics of that and I could let you know later.

Q. Yes, I would like to know later.

A. Of course, there is a very good reason for water movements to United States ports, and this is, of course, that foreign bottoms cannot be used in cabotage in the United States. So we load lumber on foreign ships in British Columbia, that is Norwegian ships, what have you, and send to the United States points instead of Seattle, which would have to send it by rail.

Q. You send that lumber through to eastern --

A. Eastern United States.

Q. United States ports?

A. Yes, because, of course, sea transportation is very much cheaper than rail up to these distances, up to New York anyway.

Q. Well, would you not say then that water trasnportation from British Columbia is reasonably competitive to rail transportation, certainly in the area which you have mentioned, that is, lumber?

A. Well, it certainly is not reasonably competitive to eastern Canada.

Q. But what about the other markets?

A. Well, of course, it is competitive to coastal points of the United States

Q. Yes?

A. But the United States is very big and if it goes to a coastal point, then of course, it cannot be shipped very far inland before you start incurring these high freight charges again.

To the coastal point in the United States I would say it is competitive, but of course, most of our market in the United States is in the mid-west, Chicago and points like that, the heavy populated areas nowhere near the sea ports. Our biggest market, I think - I am not sure but I think it is in the mid-west of the United States.

Q. But in any event there is a water movement of lumber out of Vancouver?

A. There is a water movement to coastal points in the United States.

Q. Exactly, and that is competitive with rail, is that right?

A. That is right.

Q. To those points?

A. That is right.

Q. And similarily there is a water movement through to points on the United States eastern seaboard?

A. To the Atlantic seaboard, yes.

Q. And you say you have not the figures for those movements, but I take it they are significant?

A. Speaking offhand now, without

checking it, I know that it does fluctuate an awful lot. Sometimes you get high shipping rates and there are no movements at all, unless there is a long-term charter and I know there are very few of those going about for lumber. So it is very spasmodic indeed, and I think we do depend very mainly on rail, and especially for the interior United States as well because shipping rates are so spasmodic and it is not everybody that can fill a ship up and send it away.

THE CHAIRMAN: Is there any water movements from Montreal to Vancouver?

THE WITNES: From Montreal to Vancouver I believe there are one or two, not very much though.

THE CHAIRMAN: They are not scheduled.

COMMISSIONER ANSCOMB: No regular schedule.

THE WITNESS: I am informed there is a regular schedule, Saguenay Terminals is one.

THE CHAIRMAN: How often do they run?

THE WITNESS: Three this year.

COMMISSIONER ANSCOMB: Three, do you mean, in a year?

THE WITNESS: Or three [illegible].

COMMISSIONER ANSCOMB: Is that the aluminum craft that do that?

THE CHAIRMAN: There was another line that we were always hearing was going to run. It has not run yet, Mr. Brazier?

MR. BRAZIER: No, I think the railways met the competition and the steamship went out of business.

COMMISSIONER MANN: Before you leave this point, Mr. Cooper - you said, Mr. Hughes, that, for example, to the eastern United States seaboard water shipping is possible because of the possibility of using foreign ships.

THE WITNESS: That is right.

COMMISSIONER MANN: In this service. Between Vancouver, and, say, Montreal or the Canadian eastern seaboard, you can use British Commonwealth Registry ships, which also, as you know, have lower wage rates than Canadian ships. Is the existence of the steamship service between Vancouver and the eastern U.S. seaboard dependent therefore only on the availability or the possibility of using foreign ships, or is there something else that enters, namely the volume? To the U.S. seaboard you could probably sell more lumber than you can to the Canadian seaboard, quite apart from the wage structure.

THE WITNESS: It does depend on this. If the United States law on cabotage included Canada, then we would not get any traffic to the United States by sea.

COMMISSIONER MANN: Are you presently shipping lumber to New York and then to Newfoundland?

THE WITNESS: I don't know.

MR. COOPER Q: Would you go to Table 15 on

page 26, Mr. Hughes, taking the waybill sample of inter-provincial movements, 1957, distance and cost characteristics of competing shipments by province, you have lumber there, British Columbia to Ontario, and you have an average charge per ton there of $28. What percentage of the sales - and perhaps I have already asked you this question and you may have given the answer - what percentage of sales of lumber, British Columbia lumber is made in Ontario? Was that figure merely two per cent derived from Figure I?

A. What percentage of B.C. lumber sales were made in Ontario, did you say?

Q. Yes, I think you stated two per cent when we were talking of Figure I in eastern Canada.

A. Yes, that is eastern Canada.

Q. Now, when you use the term "eastern Canada", do you mean anything ---

A. Yes, I mean eastern, I mean Ontario, Quebec.

Q. What is the principal source of competition for British Columbia lumber in the eastern Canadian market?

A. Oh, we have Maritimes - speaking about lumber alone here we have Maritimes, the United States. It depends what type of lumber you are talking about, but we have United States lumber coming in.

Q. Well, perhaps you want to distinguish them between various varieties or grades or types

of lumber?

A. When we are selling from the coast of British Columbia, then we just cannot reach the Ontario market with this dimensional lumber. We are being cut right out of that market with the percentage increases since the war.

Q. So you have no sales of dimensional lumber in the eastern Canadian market?

A. In the eastern Canadian market; from the coast, from Ontario, which is nearer.

Q. I understand that term to be 2 by 4's generally?

A. Yes.

Q. Or lumber of other dimensions generally used in building construction?

A. Mainly in construction, yes. Now, from the interior, of course, they do compete in eastern Canada and their main competitors are Ontario and the Maritimes, Quebec.

Q. So from the interior of B.C. dimensional lumber is shipped into eastern --

A. Is competitive in eastern Canada.

Q. And is competitive there with the dimensional lumber from the Maritime provinces and Ontario and ---

A. Ontario, Quebec, and I believe United States too. Now, coming down to the type of lumber which only British Columbia sells in Canada, then we are competitive in eastern Canada and also

in the eastern United States, in the mid-west, particularly with Oregon, Washington, and this is our main competition there - for the big types of lumber, square lumber.

Q. Timbers?

A. Big boards, and so on.

Q. Timbers, and clears I believe.

A. Yes.

Q. And with that class of lumber you are competitive or in competition with the western United States sources?

A. That is right.

Q. In the United States market, the mid-west and the east, and in the eastern Canada market, is that correct?

A. Yes.

Q. Have you any information at all on how much of the market in eastern Canada is supplied from western United States sources and how that timber gets in?

A. I don't know the figures and I don't really know if I could get them, unless I went and asked a lumber man around here somewhere. I wouldn't know really where to get the figures from

Q. Has the eastern Canadian market been expanding for British Columbia lumber or contracting in recent years, do you know that?

A. Over the years, I would say it was contracting because we have lost a great deal of

this dimensional lumber, and especially now it is contracting. We have an awful lot of competition in there, especially from the west coast of the United States.

Q. And, I presume, substitute products are coming in to take the place of lumber?

A. Yes, there is always that, plastics and steel and concrete.

Q. This Table 15, like others in this submission, and this is what I have already touched upon, gives an average charge per ton without regard to distance. Do you consider that the average charge per ton for lumber, British Columbia to Ontario, as compared with the like charge, New Brunswick to Ontario, is unreasonable, having regard to the difference in average hauls? You have got an average charge per ton for a haul of 2,516 miles in the case of British Columbia of $28; in the case of New Brunswick, $18 for an average haul of only 836 miles.

A. Well, of course, we have the average charges per ton from British Columbia, $28 there. Whether that is reasonable or not depends a lot on the cost, and, of course, we have higher car loadings from British Columbia. We are sending through in fully loaded cars. I think probably 40,000 lbs. would be a good estimate, 35, 40.

COMMISSIONER MANN: 40 you say?

THE WITNESS: Oh, I beg your pardon, 60,000.

MR. COOPER Q: I am only thinking of the figure as relative.

A. I am looking at whether they are reasonable in terms of the cost that the railways have in getting it through to the markets, and it is very hard to say whether they are unreasonable or not, but I would look at it this way, that while we don't know much about the cost, the charges are pretty high, but we don't know much about cost, the relative cost between New Brunswick and British Columbia.

Q. In previous questioning this morning, Mr. Hughes, I think you indicated fairly clearly that what British Columbia is concerned with in this submission is the absolute charge of getting to a market -- the absolute charge per ton, or whatever measure there might be -- rather than any relative charge?

A. That is right. There is a lot of reasons why the charge is $28. It may seem low to you, but the cost per ton-mile and the distance to the shipper does not mean anything. He does not know anything about that. What he looks at is the charge per ton. It is $28 as against $18 from New Brunswick into this competitive market.

Q. The situation in this table is the same as the other. What British Columbia is really saying is: Our charges are high, and we are not interested in the relative situation. Is that right?

A. That is right -- well, I would not say we are not interested in it, but I do not think the figures to the shipper are meaningful.

Q. And if they are not meaningful to the shipper, then I take it that British Columbia, in this submission, is not primarily interested in them; is that right?

A. Yes.

THE CHAIRMAN: But our problem is that the man from New Brunswick is a Canadian as well as the man from British Columbia. He is a Canadian citizen,

is he not -- the man from New Brunswick?

THE WITNESS: I realize that, Mr. Chairman, and they are both competing in this market. I am talking about comparative costs of getting the product into the market. I am not saying one is high or low.

COMMISSIONER GOBEIL: You must conciliate that with the cost of service.

THE WITNESS: The $28 may seem low to you as against $18, but we do not know the costs, and, as I say, we get 68 lbs. in a car of lumber; what do we get in New Brunswick? The car loadings might be the same.

COMMISSIONER MANN: About 52.

THE WITNESS: The relative costs of the service may not be very much out. We just do not know.

MR. COOPER: Q. Mr. Hughes, commencing at page 26 at the bottom, you deal with the question of horizontal percentage increases. I quite realize that if the cost of service principle is found acceptable and is recommended and is put into effect then we would not have, according to your submission, any further horizontal percentage increases, and that problem would disappear. That is right, is it not?

A. Yes.

Q. Now, assuming for the moment that this cost of service principle is found unacceptable and is not put into effect, have you any suggestions as to how this Commission should deal with this problem of

horizontal percentage increases?

A. Well, I must start about it by saying that horizontal percentage increases are completely outdated. I cannot see any reason or any good sense for them in an age of competition. They are completely outdated. They just do not belong any more in the Canadian freight rate structure. I deal with this in my brief. If we do not get Part 2 accepted, then what are we going to do? I think that percentage increases are not in the best interests of either the railways or of the shippers. From the shippers' point of view, of course, a flat increase puts the burden on the long haul. It inhibits traffic movement. The bulk shipper gets burdened. The railways are not making the best of their opportunities. They are not looking at individual rates in the light of the cost and demand relationships, and I think that individual tariffs, or blocks of tariffs, should be increased selectively, taking account of the out-of-pocket increases, of course, and the demand conditions. Now, I would put a limit on that. If we take the demand conditions for captive traffic, then, of course, they would take pretty well all of the percentage increase, so I think that the captive shipper must be protected in some way precisely because in the growth of competition, any percentage increase at all would place more and more of a burden on him. I would go for selective rate increases on selective tariffs in relation to cost and demand.

Q. Your answer is selective rate increases?

A. Yes.

COMMISSIONER MANN: Mr. Hughes, is not that essentially, apart from the captive traffic, what happens today, except that the railways make the selection after the application rather than before the application?

THE WITNESS: They then put the 17 per cent increase onto all of the non-competitive traffic. That is a flat percentage increase. Then, a lot of that non-competitive traffic immediately becomes competitive, and they are not being very selective in it.

COMMISSIONER MANN: Where the demands of schedules indicate that a hold-down should be applied, or a reduction should be made, following the imposition of the increase, then that is being done so that you have, in effect, a selection, or a selective increase, after the Board has authorized a general increase.

THE WITNESS: Well, you may do, but by that time it is too late because the traffic has already gone to the trucks. The shipper finds he is getting the service by the trucks, and whatever the rate the traffic will never come back to the railways in a great many instances. So, even though they may be doing it in a rough way, they put the increase on the non-competitive traffic and they wonder why they lose that traffic to the trucks.

COMMISSIONER MANN: Do you think it would bring about the desired end to have selectivity before

the authorization, rather than after?

A. I certainly do, yes.

THE CHAIRMAN: Does not the taper principle correct the horizontal percentage increase for the long-haul shipper?

THE WITNESS: No, it does not, Mr. Chairman, because we are paying, in the example here, $28 a ton as against New Brunswick's $18 a ton.

MR. COOPER: Q. That is in Table XV?

A. Yes.

Q. And that is on page 26?

A. Yes. With a 10 per cent rate increase, we pay an additional $2.80, and the New Brunswick shipper pays an additional $1.80, so the relationship between the producers gets worse and worse as we go on with percentage increases.

COMMISSIONER MANN: That is on the proviso that your rates on lumber are not related to the American rates, and therefore do not take the Canadian increases in many cases.

THE WITNESS: Well, we get American increases at some time or another. They are not done at the 19[illegible] level.

MR. COOPER: Q. I now move to Chapter 2 of your submission, Part 1, dealing with the bridge subsidy. We have had a great deal of evidence about the bridge subsidy, and I do not intend to go into it in any great detail, but I would like to direct your attention to a statement at page 37, which I suggest is not correct.

You say there:

"A great deal of traffic in the open navigation "season travels by rail-lake-rail at rates "below the all-rail tolls. This traffic, as "it goes by water and does not travel over "the bridge, does not qualify for the subsidy. "However, the railways feel compelled to "apply the normal differentials in order to "maintain rail-lake-rail traffic, and the "differentials are based on all rail rates. "On rail-lake-rail traffic, therefore, the "railways receive lower revenues than they "would in the absence of the bridge subsidy."

I am instructed, Mr. Hughes, that the water carriers absorb the bridge subsidy reduction in their portion of these rail-lake-rail rates in order to be on a competitive footing with the all-rail rates. Is this correct?

A. Yes, but my understanding in this is that this is on railway and on ships, and the authority for this statement, if I may give it to you -- it is my understanding that it is on railway on ships that they apply the differential below the bridge.

Q. Well, in any event that is your understanding?

A. Yes, that is my understanding.

Q. I am not going into whether that is correct or not, but you were going to mention the source.

A. Yes, if I may I will read exactly what they have to say here.

Q. What is that book you are reading from?

A. This is a book entitled "Traffic Studies" published by the Canadian Manufacturers' Association. It has no date. At page 46, it says this:

"One aspect of this 'Bridge' subsidy is "of particular interest. The figure of seven "million dollars is the presumed cost of "maintenance (not operation). The amount of "this subsidy is required to be translated to "reflect an equivalent reduction in the "All-Rail rates on traffic passing over this "'Bridge'. But a large portion of East-West "traffic during the season of navigation travels "by rail-lake-and-rail and at specific differen- "tials below the all-rail rate. Such rail- "water traffic, inasmuch as it does not travel "over the 'Bridge', is excluded from the cal- "culation involved in translating the subsidy "into reductions in rates. If, however, the "rail-lake-and-rail routes are to be main- "tained, the carriers must apply the normal "differentials. The result has been that the "carriers in order to maintain their lake "routes, must base their differentials on "the reduced all-rail rates. Therefore, the "railways, on rail-lake-and-rail traffic, "receive less than they would otherwise obtain

"and, of course, do not gain (or lose) on all-
"rail traffic. The net result is that the
"railways joining in such rail-water routes
"actually lose because of the 'Bridge'
"subsidy."

That is my authority, and it is my understanding that it is railway and ships. Now, it may apply to other ships.

Q. Your understanding is that it is what?

A. It is my understanding that it is railway on ships.

MR. COOPER: Well, our friends from the railways can go into those points, but that is not my understanding.

MR. McDONALD: The Canadian National has no ships.

MR. COOPER: Q. There is a statement preceding what I read on page 37 which is as follows:

"Not only British Columbia loses by reason of
"the bridge subsidy but the railway dissipates
"its revenues by voluntary reductions not
"required by law, thus further burdening the
"shippers who have to pay full rates."

What do you mean by "voluntary reductions not required by law"?

A. I think the two paragraphs should be joined together. I mean precisely this rail-lake and all-rail situation.

Q. When you say "voluntary reductions not

required by law", you are referring to reductions which you have said the railways make in connection with this rail-lake-rail movements to hold the differential having regard to the bridge subsidy and which I have intimated is not the situation.

A. That is right.

Q. I have said that I am not going to go into any detail on this matter of the bridge subsidy, but I just want to put to you in as short a form as possible what I understand to be the position of British Columbia in respect to this subsidy, and you can tell me whether I am right or wrong. As I understand it, British Columbia maintains that the bridge subsidy causes these shippers unfair competition in the prairie markets because the products of British Columbia compete in those markets with products moving from Ontario, those products having received the benefit of the bridge subsidy and, therefore, being subsidized where the products moving from British Columbia are not being subsidized. Is that correct?

A. Yes.

Q. And, secondly, that this disadvantage suffered by British Columbia is not compensated for by any advantages obtained by British Columbia.

A. Yes.

Q. The only possible advantages obtained by British Columbia are too small to be given serious consideration because only 20.5 per cent of carload traffic originating in British Columbia on the 1957 figures

moves over the bridge, and of that 20.5 per cent only 20.4 per cent is eligible for the subsidy; is that right?

A. Yes.

Q. Furthermore, there is only a small movement of subsidized traffic into British Columbia, and that movement is too small to be significant in volume, and, in any event, that movement into British Columbia of traffic which has received the benefit of the bridge subsidy unfairly competes in British Columbia with British Columbia distributors; is that correct?

A. That is right, yes.

Q. Does that summarize, then, the position of British Columbia with respect to the bridge subsidy? That, of course, leads to the recommendation which you have made at page 37 that the bridge subsidy be abolished?

A. That is right.

Q. Now, I move on to "Unremunerative Services" which commences at page 39. In the first paragraph you define out-of-pocket costs ---

MR. FRAWLEY: Mr. Cooper, there was one statement on page 33 in respect to which the record needs correcting. I do not know whether Mr. Hughes knows this, but he says that on coal to Ontario the bridge subsidy does not apply.

MR. COOPER: Mr.Frawley, that was corrected by Mr. Brazier this morning, I think, before you arrived.

[illegible]

perhaps.

THE CHAIRMAN: Yes. It has only been in effect for a few days.

MR. COOPER: Yes, since June 1, 1960.

MR. FRAWLEY: Yes. I do not know whether any coal has moved yet, but some of that coal originates in the Province of British Columbia.

---Luncheon Adjournment.

--On resuming at 2:00 p.m.

THE CHAIRMAN: Order, please.

MR. COOPER Q: I had just commenced, Mr. Hughes, at the luncheon adjournment, Chapter 3 on unremunerative services. I refer you to your first paragraph there where you define out-of-pocket costs as including not only direct expenses such as labour and materials but also depreciation and interest on the capital employed in such services.

Is it accepted practice, Mr. Hughes, to include depreciation and interest in out-of-pocket costs?

A. Yes, it is accepted practice. These are true out-of-pocket costs, they are variable costs. I have gone into it a little more in Part 2 where I define exactly what I mean by "out-of-pocket costs" as being average variable costs. I am using the term as average variable costs. If the costs vary with the traffic, and this is a long enough period, then it will include depreciation and interest on capital. Out-of-pocket costs would show up if you are doing a regression on it the way it has been done in the grain study, and out-of-pocket costs would show every cost that varied with particular traffic or the output unit you are using. It would not from an accounting basis, but from a statistical basis it would include depreciation and interest on capital employed.

Q. Your definition of "long run" is a period sufficient to show or to cover normal business

fluctuations, that is two to three years.

A. Yes, I think long enough. The railways used three years in their grain study, and I talked about this matter to other railway people and they thought two or three years was a normal time.

Q. In the second paragraph you have the heading "Effects of unremunerative services", and it is the first sentence:

"The effects of providing non-compensatory services are well known".

I take it you are using the words "unremunerative" and "non-compensatory" as synonymous. Is that correct?

A. That is correct, yes.

Q. In the paragraph commencing at the top of the second column at page 39 you state:

"The raising of rates above costs encourages, say, trucking whose costs may be higher than rail but whose rates are lower." -

and then you point a misallocation of resources occuring.

Would you just explain and perhaps comment on that sentence I have read? I am not quite sure I understand the meaning.

A. Yes. I am here talking about co-ordination of transportation. I am saying that each type of transportation should get the traffic for

which it is best suited. Now, there is only one way to do this; there is only one way to do it in Canada, and that is through our price mechanism, where the agency, the transportation agency with the lowest price will or should - or, rather, will get the traffic. Now, then, this depends on the shipper, of course, having a free choice, as we assume he does in Canada; it also depends on whether the prices charged are based on cost. If the prices are based on cost, then the shipper, of his own free will, chooses the form of transportation which is the least costly from the point of view of providing the service. If there is no freedom of choice, then obviously there is no co-ordination, or if we get interference with the cost mechanism so that prices are below the cost of providing the service, then obviously the shipper will not be interested in the cost of railway or trucking working; he is only interested in the price he will get charged. So he may, in fact, through going to the agency with the lowest price, be using the high cost agency, and this is what I am saying here. If the railway loses money, out-of-pocket loses, and attempts to recover them somewhere else, then it may result in this un-coordination, or whatever the word may be.

Q. You mentioned in Canada coordination of transportation media is accomplished by means of the price mechanism. Is there any other way of doing it? It is done other ways in other places?

A. Well, presumably - and I don't know - presumably in the Russian system there is a man who, say - or any system like that - there may be a man who tries to put traffic on to the form of transportation to which he thinks is best suited to carry the traffic.

Q. In other words, what you are saying is that in a free enterprise economy coordination of transportation media is and should be accomplished through the pricing mechanism?

A. Coordination of transportation media can only come through the pricing mechanism, yes.

Q. On page 42 you are referring generally there to policy recommendations for the passenger deficits, and in your submission on passenger deficits as contained on page 42 and generally in your chapter here you take the position generally, as I understand it, and, among other things, total abandonment of the particular service which incurs the deficit, and you refer to that specifically on page 43, and at page 44 you say that new thinking is needed on abandonment policy.

Now, can you assist the Commission by any suggestions in addition to or supplementary to what you have in your submission as to what changes should be made, by legislation or otherwise, in passenger services abandonment policy?

A. I don't know that I can help the Commission very much because they know much more about what is public interest than I do. What

may need to be looked at - and I am not saying it does, in fact; I am not sure where the onus lies now, but in this Section 168 of the Railway Act, as I read it - I don't know if I have got the right one there - anyway the onus seems to be now on the railway for proving a case in abandonment. Now, it may be in the national interest, in the public interest; I don't know. It may be we need to speed up abandonment, especially if passenger service, more so, than, I should say, freight service - and it may be this should be looked at; maybe somebody else should have the onus.

Q. You used the phrase "in the public interest" and the words "the national interest" What do you understand by that phrase?

A. I am thinking of the interest of Canada as a whole and Canadians as a whole and shippers and passengers, commuters, industry - everybody who has an interest in the nation's welfare in Canada. I don't conceive of public interest as being the public interest of a small village somewhere served by a passenger train that may run once a week; I don't think this is public interest. I think we should have a much wider view of what the interest is. It is really the interest of Canada that we are looking at and not the interest of perhaps small segments at the disadvantage of other Canadians; you may have to look at other positions.

Q. Is your position, then, on passenger service abandonment that the railways should be given greater latitude than they presently have?

A. Well, it may need looking at, and, to tell you the truth, I am not the guardian of the public interest and I --

THE CHAIRMAN: Should be changed.

THE WITNESS: No, I think that new thinking is needed on it, and I haven't really thought about it too much, and if I said such and such changes are needed I may change my mind about it tomorrow, because I don't think I am a sufficiently knowledgeable to know what is public interest in Canada and to know what is needed doing. It doesn't seem to be a very definite answer, I am afraid.

MR. COOPER Q: On page 46 you mentioned if a community deems the service - and there you are speaking of commuter services - to be essential, then it should find the means, either by subjecting itself to fare changes, or by subsidy, or a contractual arrangement with the railway, to maintain it.

I think what you are saying there is if a commuter service is unremunerative and a city wants it or some other local authority wants it, then it is up to that city or that local authority to provide money to the railways to provide the service without losing money.

A. Yes, that would be a good way of doing

it. I have clipped something out of one of the traffic journals, and I see Philadelphia is subsidizing rail commuter services, and Mr. Donald Gordon, before the Royal Commission on Canada's economic prospects, suggested the same thing, that contractual arrangements with the particular municipality interested in such a service may solve the problem.

Q. You would consider that such subsidies or financial assistance to maintain these unremunerative commuter lines should be maintained at a local level rather than a provincial or national level?

A. I think the local level would be the first place to start, and if the local level was not rich enough and it was in the provincial or national interest to keep the service, then the assistance should get higher and higher. Services which affect one particular community and the railway wants to abandon it, then it may be in the national interest to look after this particular problem to look after the interest of Canadians as a whole.

Q. I want to ask you one or two questions with respect of abandonment of branch lines, and, incidentally, I think that section of the Railway Act to which you have just referred as, Section 168, applies to abandonment of operations of lines of railways other than passenger services. But, in any event, have you

any specific suggestions to make as to changes in legislation or otherwise on the question of abandonment of branch lines?

A. At this stage I would say no. I think I would have to look into it and go through the Railway Act and the present law to see what happens.

Q. Have you given any consideration to this matter in connection with your suggestions for a new pricing structure contained in Part 2 of the submission? If the railway rate making proposal contained in Part 2 were brought into effect, what would be the position with respect to branch lines? I don't want to anticipate your Part 2, but I thought I would put that question to you.

A. I think that many branch lines would automatically be priced out of existence, and then if this was done or was in the national interest or somebody's interest to keep those lines there, say, because of grain or something else, then I can see the railway system as being a main line system with healthy feeder routes, branch lines, feeding into the main arteries, and I think if that was accepted, then a lot of the branch lines may reflect their true costs. I think our Part 2 would bring about a main line system with healthy feeder lines on it, and the true cost of transportation would be reflected.

Q. When you are speaking of healthy

feeder lines, you are speaking of healthy branch lines?

A. We would knock off all those branch lines, if it reflected their true operating costs, and there may be some alternative means of transportation, but the railways are only kept on that line because the prices don't reflect the true cost of that line.

Q. To enable your proposal to be effective, should it not be made easier for the railways to abandon branch lines?

A. I know it is very difficult to - or the railway says it is very difficult to abandon branch lines. In recent cases I haven't found any instances really where the railways have been denied - I think there are just one or two cases, but they are becoming very rare. It doesn't seem to be too difficult now to abandon branch lines. Now, when the worst branch lines get off the system and we come into marginal cases, then it may become very difficult.

Q. What you are saying is that once an application is before the board, then it seems to meet with success for abandonment of branch lines?

A. Yes. But Mr. Donald Gordon again - I would like to read what he says, if I may.

Q. Yes, do.

A. This is the House of Commons First Session - Twenty-fourth Parliament, 1958, Sessional

Committee on Railways, Air Lines and Shipping, Proceedings and Evidence No. 1, 14th and 15th July, 1958, page 94.

"MR. GORDON: I have a statement here that goes back into the years on the track miles abandoned. The record of the last thirty years shows that we have abandoned a matter of 1,269 track miles and in the period 1955 to 1957 which I presume you are especially interested in, the abandonment was 165 miles of which 155 miles were in Canada.

MR. BROOME: Should not that program be accelerated?

MR. GORDON: We would like to accelerate it in many cases, but when it comes to the abandonment of lines, as I said earlier today, that carries very fierce opposition, and we cannot abandon a line without an order from the Board of Transport Commissioners. We have a Hearing because anyone who has any reason, legitimate or otherwise, to object to that has the privilege of appearing before the board and stating his objections. The abandonment of lines is one of the things we must do in many cases to cut down our deficit, but the resistance and the objections that are raised every time makes that practice very difficult indeed."

Now, that is the end of the quotation, but

it does point out the fact that the railways have the feeling that there is a great deal of difficulty in abandonment. But unless I go to the hearings and read the transcript, which I don't - I haven't time to do it - I can only assume there is a very great deal of difficulty in abandonment.

(Page 13487 follows)

Q. Well, that is precisely the point of my question. Do you think that some of those difficulties or all of them should be removed by changes in the Legislation or otherwise, so that when the railways apply for abandonment, they are not going to be faced with the fierce opposition that Mr. Gordon speaks of, if of course they are able to establish that the branch line is unremunerative?

A. Again I am not prepared to say whether the Legislation is changing. It may be the regulations need changing; it may be the Board will do it automatically without any change in anything, just in its thinking. I do not know really what is in the public interest at this stage. I just cannot, I am not qualified really to say what is the public interest I don't think.

Q. Now, it might be suggested that in this matter of abandonment of branch lines, once the railways established that the branch line was unremunerative, then the entire onus should shift onto those opposing the application, and indeed, perhaps it might even be suggested that the Board of Transport Commissioners then would take action on their own motion with respect to abandonment of branch lines, so that the fierce opposition would not be directed at the railways but rather at the Board. Now, would you have any ideas on those points?

A. I think the onus is shifting now, the onus seems to be shifting to the shippers without any change in the Act. It just seems to be that the

[illegible]

shippers and the people interested in the community have a tough time -- I know it is very tough for these people -- and they really turn out in force and try and prove that the branch line is not necessary.

Whether you have to change the Act to do it -- I am not a lawyer-- or whether it will just happen, I don't know, but another point I would like to say on that is that I cannot see the Board ever going out on its own motion and ordering a branch line-- because it just would not have the cost figures necessary because I do not think there is any adequate staff now in the Board that could look at railway costs and branch lines and so on.

Q. I am presuming that the Railway has established to the satisfaction of the Board that the branch line is unremunerative, and then from that point on the Board takes ---

A. That may well be an answer, but I just have not thought about it. I do not think I could add much.

Q. Thank you. On the Crow's Nest Grain chapter, I have not very much to say, but we have heard a great deal of it. I just want to turn to page 54, to your recommendations.

"Specifically, it is recommended that, as the
"continued stimulation of agriculture in the
"West and the encouragement of grain exports
"are in the national interest but shippers of
"other freight should not be unduly burdened,

"then '(1) Crow's Nest Pass rates should remain
"under statutory control and at the existing
"level'."

Do you visualize those rates remaining at the existing level permanently or for a period of time until the world wheat market improves, if it does, or what have you in mind there? Must the statutory rates always remain where they are now, at least as far as one can foresee the future?

A. Well, I cannot foresee what level of income farmers are going to get in the future. I have not studied the situation of farm income too much, but the general impression I get is that the statutory rates will have to remain at the existing level, if the prairie provinces are going to continue to be a help to Canada in the exports of wheat and so on that they are now. If this is for the future, it depends an awful lot on economic conditions that I am certainly not qualified to speak about. I can make hazy guesses about the future but that is all they are.

Q. Well, on the assumption that farm income increases or world wheat prices increase, on that assumption, should then the Crow's Nest Pass rates be taken out of the control of Parliament and allowed to find their own level?

A. Those are too pretty well assumptions, if you don't mind my saying so. I think the wheat market is getting more and more competitive, and I see no trend that farm incomes are going up. If farmers should

really get rich, then how do we know next year they are not going to get poor, and how do we know that the wheat market is not going to drop out again? We just don't know.

I think there are more people better qualified to say on the wheat situation than I am.

Q. Well, your second recommendation:

"A subsidy should be paid to the railways
"from national funds. The subsidy should
"recompense the railways for out-of-pocket
"losses arising from the carriage of such
"grain, plus a fair contribution to overhead
"at the end of each crop year."

Now, as I understand it, that involves the determination each year of out-of-pocket losses and a determination at the end of each year as to what would be a fair contribution to overhead.

A. That is right, yes.

THE CHAIRMAN: What would be a fair contribution?

THE WITNESS: Whatever the Board of Transport Commissioners, I think, thinks that the farmer should bear. Well, the farmer should bear a fair contribution, if it has been a good -- I was going to say -- if it has been a good wheat year, then there would not be any need for a subsidy.

If there are out-of-pocket losses in each year, then the railways should be recompensed for that. A fair contribution to overhead, I think, would have to

[illegible]

be determined by the Board here.

THE CHAIRMAN: Well, what would you recommend?

THE WITNESS: Well, what the traffic would bear is what I would recommend, what the Board thinks that the -- no, that is not a very good answer. On the basis of a subsidy for it, fair contribution to overhead, I think, say, the capital cost and so on, depreciation, if these enter into overhead at all. I don't know.

COMMISSIONER MANN: When you say depreciation, we had that invariable cost earlier.

THE WITNESS: I know, but then you have the constant expenses on the solely related lines, I presume, and things solely related to grain that may have to be taken into consideration then, or would have to be.

THE CHAIRMAN: In this term you use "fair contribution to overhead".

THE WITNESS: Yes.

THE CHAIRMAN: Do you agree with the C.P.R.'s submission in this connection, do you go that far?

A. I certainly do not, no. Well, fair contribution to overhead here, I think what I had in mind was the constant expenses which are solely related to the grain traffic. That is what I had in mind.

MR. COOPER: Q. Are you using out-of-pocket losses? Perhaps I had missed this point. Are you

using the term "out-of-pocket losses" there as in the same sense as ---

A. Yes, when the rates are below out-of-pocket costs, then this is an out-of-pocket loss as I like to look at it.

Q. Why should the railways receive the subsidy? Had you given any consideration to payment of the amount of subsidy to the shipper, allowing the rates to be fixed, of course, on what might be termed a just and reasonable level?

A. I think it would be extremely difficult to administer a subsidy in that way, to give it to the shipper.

Q. Is that your only objection, to giving the subsidy direct to the shipper?

A. I think it is, yes.

Q. Just one of administration?

A. Yes, that is it.

Q. Well, assuming that that difficulty is not a very reasonable one, which would be the more desirable -- subsidy to the railways, subsidy to the shipper?

A. I think a subsidy to the shipper.

Q. Why?

A. And here I am speaking really for my own position.

Q. Yes.

A. And I do not know really what the British Columbia Government may think about it, because

[illegible]

we also have some grain shippers in British Columbia. There may not be many, but they are there.

I think then that traffic would give it a chance to move by truck over the branch lines. We may not have such a big branch lines deficit as we have now. If the subsidy is paid to the shipper, he will get free choice of service.

Q. That would result in a better allocation of resources in the transport industry as a whole?

A. Yes.

Q. You consider then that if rates were allowed to rise for the shipment of grain or the carriage of grain to export positions, that truck competition would enter?

A. Well, of course, it all depends on the level.

Q. Oh, yes.

A. Of the increase, but certainly truck competition is a very potent force in the United States. I know there are competitive rates for grain, truck competitive rates. I don't know, but I have no doubt there are truck competitive rates for domestic grain in Canada now.

I think that gradually it would take a shift, especially on the branch lines, to trucking into what I would presume to be the big elevators.

Q. Coming to your fourth recommendation,

"That the inequities suffered by other

"shippers as a result of the statutory rates

"be adjusted from subsidies received by the
"railway",

had you contemplated there that the entire subsidy received by the railways be used to reduce other rates or what?

A. Well, we had in evidence, I think it was Mr. Edsforth who said -- I will just have a look and see. This is what Mr. Edsforth said in Volume 13, page 1815:

"MR. BRAZIER: Q. Can you give me any
"indication of what the percentage increase
"would have been had you been able to increase
"the statutory rates on the various increases
"that occurred since 1950, what the percentage
"would have been?
"A. Well, that is quite an involved
"calculation, Mr.Brazier. I would think
"around -- it may have been 115, 112 per cent,
"I don't know; it would be in that range,
"I think.
"Q. Rather than ---
"A. 157.
"Q. Instead of 157?
"A. Yes.
"Q. For my purposes that is close
"enough. So, to that extent the difference
"between 112 and 157 per cent increase, I suggest
"to you, that may have been a burden on other
"shippers?

"A. To the extent that these increases "have all been paid by other shippers, yes; "that hasn't been the case in many instances." So I think, from what Mr.Edsforth said, that it has been a very big burden on other shippers and the rates have gone up, freight rate increases, 157 per cent over the general rate cases; whereas Mr. Edsforth thinks they should gone up at only 115 or 112 per cent, had we not had the problem of the statutory grain, and this is, I think, a burden on the other shippers. Whether the railways have a burden or not, I don't know, I have no evidence on that.

Q. Then you are suggesting that the subsidies received by the railways be used to alleviate that burden in some way?

A. Yes.

Q. Would you do it by formula in giving the release to all shippers, or how would you deal with the situation? What I am getting at is this, Mr. Hughes. If the railways are right in saying that they are losing money on grain and they need large sums of money to compensate for their losses in carrying this traffic, then I do not see that their situation is remedied if they just have to take that money and use it in reducing rates paid by other shippers.

A. Well, if this money has been paid out to the railways and to the Crow's Nest shippers by the other shippers in the country, I think some way should be found to reduce the tariff for those people who have

had this very real burden.

Q. And is that way out of the subsidies which would paid to the railways?

A. Yes.

Q. So that the railways might be left financially no better off even if the subsidy were put into effect?

A. I don't think, I have not seen any evidence where they are financially worse off. There may be some evidence, I don't know, where they are financially worse off by the Crow's Nest. There may be evidence I am not thinking about here. That is something that perhaps needs to be established, but assuming it is ---

Q. My question would be on the basis of the railway being able to establish it.

A. Yes, I say the shippers who have suffered -- and I think they have really suffered by these increases -- should be recompensed in some way through the reduction in tariffs.

COMMISSIONER MANN: Are you leaving that subject?

MR. COOPER: Yes, I am, sir. I should be glad if you want to ask a question.

COMMISSIONER MANN: A couple of things. First of all you quoted Mr. Edsforth in Volume 13. If my memory serves me correctly, this was discussed with Mr. Edsforth and it was pointed out to him that the erosion and attrition factors may have been quite

different, lower percentage increases which might have been required,which might have been asked for if the Crow's Nest Pass rates had been at a higher level. Mr. Edsforth, I think, conceded that, and therefore that figure of 112 to 115 per cent perhaps needs to be modified to some extent. I just wanted to get this correct.

THE WITNESS: I had better have a look because I do not remember. 1816, I cannot see Mr. Edsforth. Perhaps somebody could help me with what is in evidence on this. I do not know.

MR. SINCLAIR: We will argue it at the appropriate time, sir.

MR. COOPER: I was just suggesting, if I may, Mr. Commissioner Mann, that we might leave this. If Mr. Hughes finds any reference that he thinks he requires in this connection, perhaps he could inform us at a later stage. Otherwise, it would be a matter for argument, as my friend Mr.Sinclair says.

THE CHAIRMAN: Would you extend the relief in the rates to those who have agreed charges and competitive rates in B.C. now?

A. Well, a lot of those agreed charges may be -- we don't know what the costs are to the railways. They may be contributing quite a lot over the so-called fully distributed cost. We don't know. We don't know what they are receiving in the way of costs.

THE CHAIRMAN: Your idea is they should have some relief too.

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

THE WITNESS: I was thinking primarily of the shippers who have been paying the burden all the years, the non-competitive shippers, in the operation of this class rate, and traffic for which there is not other means of competition than rail.

THE CHAIRMAN: But had you in mind the others too?

A. No, I had not. I did not have that in mind at all. It is the captive shipper, I believe, who gets all the freight rate burden over the years. I think their tariffs should be reduced in some way or other.

MR. COOPER: Q. You are not suggesting you would make that restrictive to pay the people ---

A. Oh, no.

Q. Who suffered in the past?

A. No.

COMMISSIONER ANSCOMB: Just before we leave this factor, Mr. Hughes, I am finding great difficultly in these suggested inequities. I am not saying there are no inequities, but when you continue to say that other freight shippers have been overburdened, what makes you think that? For the moment, leave out the C.P.R. who, after all,probably, under financial statements, do not make very much out of the bag of tricks as far as railways are concerned; but take the C.N.R. who lost $43 million or $46,300,000, whichever the figure was, last year, and $50 million the year before. Assuming that they had got all of what they say is the

normal rate for grain, they would still have a loss, so how could there be any overcharges of the other shippers?

A. Well, even if the C.N.R. did still have a loss, say, of $10 million, say ---

COMMISSIONER ANSCOMB: All right.

THE WITNESS: Well, there is still quite a lot of money in there, $30 million, is it, balance that is incurred by carrying grain at less than the out-of-pocket cost, if it is ever established that they are carrying grain at less than out-of-pocket cost. Then I say that it also seems to me that the other shippers, somebody has been paying for it, and on the C.P.R. it is a clear case.

MR. SINCLAIR: We cannot hear.

THE WITNESS: On the C.P.R. it is a clear case. The C.N.R. tariffs are just the same as they are on the C.P.R. It is the rates that have gone up by 157 per cent as the general level as against 115 per cent that they would have been had there been no out-of-pocket losses on the statutory grain. So I think that the captive traffic or the normal traffic has suffered through this, because somebody is paying the bill.

MR. COOPER Q: Mr. Hughes, your next chapter is on the one and one-third rule, and so long as Mr. Frawley is in this court room I would not presume to trespass on his territory and ask any questions with respect to the one and one third rule.

A. I think he is quite satisfied with this.

MR. FRAWLEY: It is all yours, Mr. Cooper.

MR. COOPER Q: Therefore, I am going to turn to Part 2 of your submission. In the first paragraph of Part 2 of the submission you state:

> "The purpose of Part 2 of this submission is to recommend to the Royal Commission a railway rate making proposal, the adoption of which, it is believed, will help alleviate many of the current problems of the railways and shippers."

Now, just so that we may have the matter placed in the proper setting would you please outline to the Commission what you consider to be the principal current problems of the railways and shippers towards the alleviation of which your proposal is directed?

A. The problems of the railways -- I think there is at present a lack of freedom to assert their inherent advantages on a very low cost movement, which is lower than any other overland form of transportation -- for solids anyway. I do not think they get a chance under such clauses as equalization to assert their inherent advantage

because they are having in many cases to give the same freight an equalized freight rate whether it is a high cost movement or a low cost movement, and I think this proposal, where it is cost-oriented, would make sure that the railways get the traffic for which they have an inherent advantage.

One of the problems of the railways over the years has been the dwindling of traffic. As the traffic has become more and more competitive then the rates in some other areas have just had to go up, and quite a lot of traffic has been lost to the truckers. I cannot see this situation getting any better. Again, if the railways are given a chance to assert their low cost advantages where they exist then I can see that the railways will get a great deal of advantage out of that.

This will be achieved by a lopping of the unproductive lines, leaving lines to trucks where trucks have the better comparative advantage than the railways. There will be an increase in production of main line traffic, or the low cost traffic. The railways will be getting this wholesale traffic instead of moving traffic around in little retail lots, a thing for which the railways were never intended. There was never any advantage in that. I think there would be a profitable railway revenue if the railways were allowed to assert their cost advantages in a cost-oriented system.

And now, as to the problems of the shippers and as to whether they would be protected, I think it depends on which particular shippers we are talking about, and I think it is very difficult to talk about the problems of the shippers without having any particular shipper in mind because each shipper has a different problem. I think one problem of the shipper is the horizantal percentage increase. This is the one obvious thing that would go out of the window if our Part 2 was adopted.

A lot of the shippers -- those in British Columbia, any way -- are unable to get into the prairie market in competition with products from Ontario and Quebec as a result of the bridge subsidy. Some shippers have no competition for their product, so as the railways get more and more competitive then the burden of any increase goes on to these non-competitive shippers, and I think that the cost of service principal adequately protects these non-competitive shippers.

The shippers who have good loading traffic will be encouraged through incentive rates to load this traffic up into carloads and thereby get an advantage in rates, so that these shippers with good loading traffic will be rewarded, and those shippers with bad loading traffic will be penalized, but probably they will go to the trucks and get lower rates from the trucks.

I think, as a whole, the railways, by

concentrating on the type of transportation for which they are best suited -- the long haul traffic and a lot of the bulky traffic -- will increase the total traffic and lower the overhead burden for all shippers. I can see a great many advantages in this type of proposal, and the main one, of course, is being able to take advantage of these inherent advantages of low cost on main line routes.

Q. In the second paragraph you mention three basic methods of rate making which, though not mutually exclusive, have distinct characteristics, and you mention the three methods as being value of commodity, value of service, and what the traffic will bear. Now, I know that you say that these basic methods, so-called, are not mutually exclusive, but, in effect, is not value of service the method, and value of commodity and what the traffic will bear elements in that method?

A. The value of service enters into all of these in different ways. The value of commodity type of rate making is the one we get in the classification. Very largely, the classification is based upon the value of the commodity.

Now, it does not always follow that the value of the service is the same as the value of the commodity. It does not mean to say that because the of the commodity is high valued, such as silk, that the value of service is always high, because the value of service is set by the competition. If a

commodity is valued very highly, such as silk, and the railway thereby charges a high rate for it, a trucking firm may come along and, working on the trucking costs, may take the silk right out from under the nose of the railways, and the class rate becomes simply a paper rate. The value of service to the shipper is merely the value of the service of the next best alternative form of transportation. As soon as we get competition introduced into the railways the value of the commodity and the value of the service start to diverge.

COMMISSIONER MANN: Do you really want to leave the impression that the value of the commodity is the factor which enters into the assignment of a rate in the Canadian freight classification?

THE WITNESS: Yes.

COMMISSIONER MANN: Are there not any other facts? For instance, when you look at the rating for potato chips and artificial flowers, and so on, surely there is some consideration given to loadability and the relation of cubic volume to weight, and other things?

THE WITNESS: Yes, there is, but value of commodity is the primary one. This is what the joint submission of the C.N.R. and the C.P.R. on statutory and related rates on grain and grain products in western Canada says -- this is under "The Principals of Railway Rate Making", and paragraph 43 on page 15 of this precis says this:

"In constructing the classification, the various factors which are weighed in allocating a rating to any particular commodity are as follows: - (1) value of the goods. (2) susceptibility to damage. (3) loading characteristics. (4) type of equipment necessary. (5) perishable. (6) packaging. (7) likelihood of contaminating other freight or railway equipment. (8) inherent danger."

I do admit all these things arise in the classification, but the first one listed here is the value of the goods. If a thing is valuable it gets a high classification.

COMMISSIONER MANN: I do not know whether that I, for one, would make the deduction that therefore that is qualitatively superior to the other elements. This may just have been in the mind of the writer of this.

THE WITNESS: The writer did not qualify it in any way. I believed him, and I think many other people believed him, that the value of the goods ---

COMMISSIONER MANN: I was interested in having a note of the source of that statement, though.

THE WITNESS: I think there are many other sources in the books, which I could give you. I did not really finish the answer.

MR. COOPER Q. Yes, do finish your answer.

A. The value of the service and -- to what extent does value of service enter into what the traffic will bear? The value of service is, as I have said, based on the value of the service set by the competition. The value of service is set by the competition. What the traffic will bear is in a slightly different position. Although the rate is based on what the competition is, what the traffic will bear is a term I used meaning charging a rate which will maximize the railways' profits or maximize the railways' net receipts.

Charging a rate according to what the value of the service is does not mean, to take it in its precise meaning -- value of service does not prevent a rate from going down below the cost of service, whereas what the traffic will bear -- and I think this is possibly done in a great deal of rate making -- always has regard to the volume of traffic moving. It is no use putting a high rate on something because you may thereby lose revenue. You might as well have a low rate and get a lot of traffic. The maximization of revenue is in what the traffic will bear rather than what the value of service is and that may, in fact, mean a loss to the railways.

Q. Thank you, Mr. Hughes. I want to direct your attention to page 5, paragraph 7, and only for the purpose of drawing your attention to your use of the term "captive traffic", that

term being the last two words in paragraph 7. I would like, before we go any further, to examine with you your definition of "captive traffic" and find out exactly what is meant. You define "captive traffic" in paragraph 111 at page 30 as being traffic for which there is no reasonable competition other than rail, the full definition being:

> "Captive traffic is defined as traffic for which there is no reasonable competition other than rail".

The first point I would like to ask you concerning this definition is the meaning of the word "reasonable" when used with "competition". What is "reasonable competition" in that definition"

A. I say captive traffic is that traffic for which there is no reasonable competition. There is no scientific basis, I do not think, of a reasonableness. It is very easy to see that a helicopter cannot be used for transportating freight over long distances, say, but it is very hard to come along and attach it to specific instances and come out with a scientific basis, especially when you get truck-rail competition, or water-rail competition, and so on. There is no scientific basis for saying what reasonableness is, and I think it can only be judged by common sense.

I think by "captive traffic" what is meant

is that there is no alternative competition at a price which will allow the goods to enter into a market. So that we may have helicopter competition and so on, but this is just ridiculous because the products would never get to the market. It must be at a price which will enable the goods to be sold.

Q. Must the competition have a large degree of stability?

A. I think the competition should be there, and should not be just a one shot in the hole by a trucker. I say it is a matter of common sense. You cannot get down to any scientific basis for defining "captive traffic", and that is why I prefer to leave it to the Board of Transport Commissioners.

Q. If at any given time the Board of Transport Commissioners is faced with determining whether or not a traffic is captive or not they must have these factors in mind -- degree of competition, stability of competition and so on?

A. Yes, I think they would use a lot of common sense in it. I would like to let you know what they do in Britain about this. In Britain, if any trader -- they call them traders there instead of shippers -- if any shipper does not think there is any reasonable competition for his traffic he can go along to the Transport Tribunal, which is the same as our Board, and he can complain that the traffic cannot

reasonably be carried by any other means. He puts his facts before this Transport Tribunal, and the Transport Tribunal looks at them and uses its common sense, and comes out and says: "You are a captive shipper", but they have no scientific basis for saying it. The man has to put the facts before them, and they use their common sense in determining what is reasonable.

Q. They give their judgement on business standards, do they, as to the degree of competition, the stability, and other matters?

A. Yes. There is a section here entitled "Protection for Traders". The book is entitled "The Transport Act, 1953".

Q. Who is the author?

A. H.S. Vian-Smith. This is at page 64. The author is explaining the Transport Act which was brought in when they altered the whole scheme in Britain.

"Protection for traders. While the new act no longer permits traders generally to make representations to the Tribunal in respect of the granting of exceptional rates or agreed charges, or in respect of undue preference to persons or classes of traffic, a major of protection remains for those whose traffic cannot reasonably move by any means of transport alternative to rail. In this regard the ~~Act~~ provides for the protection of traders against

unreasonable or unfair treatment as to charges.

The first qualification necessary before effective representation can be made is that the traffic concerned cannot reasonably be carried by any other means of transport. Such traffic as coal, minerals, iron and steel in bulk, etc., may in the normal circumstances be regarded as examples of this. Once that qualification is established, a trader who is of the opinion that the charge he is, or will be, required to pay for the carriage of his merchandise in those circumstances is unfair or unreasonable, may complain to the Tribunal. It will first be necessary for the Tribunal to satisfy itself that the merchandise concerned can only reasonably be carried by rail."

I think there that they are relying very largely on common sense.

THE CHAIRMAN: We will take the afternoon recess at this point.

--A short recess.

(Page 13514 follows.)

/1d

Q. We have discussed, Mr. Hughes, the phrase reasonable competition, and I would like to direct one more question to you with respect to your definition of captive traffic. Does this definition mean in effect that all traffic moving at class rates and non-competitive commodity rates is captive traffic and that no other traffic is captive?

A. It doesn't mean that no other traffic is captive. It means as a start, I envisage this as a start to make these things easy. All normal traffic not being carried would be put under the maximum scale. There is also other traffic, of course, which is competitive only with rail; there is no reasonable competition elsewhere. So that would immediately be put into it if the Board thought it should go there, and there are obviously examples of that, of course.

Q. Would the Board have any choice in the matter if, in fact, it was captive traffic that would have to have maximum schedules applied to it?

A. The Board wouldn't have any choice there. If the railways then thought that it wasn't captive traffic, then, of course, they could go along to the Board and state their case.

Q. You mentioned you could give examples. Would you furnish the Commission with examples of the captive traffic and being traffic not moving at class rates and non-competitive commodity rates?

A. The only competition would be rail. I would say a great deal of the lumber movement was

under a great deal of competition by rail, and a great deal of mineral products would be. There may be some livestock. There are examples of commodity rates, competitive rates, I think, where the competition is in the railway, probably a United States railway.

Q. So although lumber is today moved at competitive rates, under your definition of captive traffic, that lumber would be captive traffic.

A. Yes, because of the railway competitive rates.

Q. Are there other commodities in addition to those you have mentioned?

A. There may be coal, domestic grain -- I can't think that they would be big items actually apart from possibly minerals and coal.

Q. What about grain moving at statutory rates, statutory grain?

A. Well, assuming they would be all maximum. But, of course, it wouldn't apply because of the statutory rate.

Q. It is captive traffic, do you mean, as long as the statutory rate is there?

A. Yes.

Q. If it became competitive, then you think it would be subject to truck competition and therefore not captive?

A. It may be on some particular lines, and the tariffs, if they became truck competitive, then they would be taken out.

Q. In paragraph 8, page 5, you state:

"The greatest competition which the railways "have to face is from trucks, many of which "are privately owned, and many others are not "subject to rate or entry control. To meet "such competition, it is essential that rates "do not diverge too greatly from costs, whereas "many present rates are an umbrella under "which lower rated but higher cost competitors "can shelter."

Would effective rates and entry control of the for-hire trucking industry lessen competition for the railways, in your opinion?

A. I really don't think so, and the reason I am saying this is because many of the trucks are privately owned, and the degree of private ownership is very large. Here we have the DBS statistics, Motor Transport Traffic Statistics, National Estimates, 1957, and I am reading from Table I, Section 1, and we see the mileage, total mileage travelled, for-hire -- and these figures are in thousands -- 845,025; private intercity, 2,088,835. Net ton-miles, for-hire, 4,666,800; private intercity, 3,274,579. Gross ton-miles, for-hire, 9,914,248; for private intercity, 9,646,428. All figures should have three 0's at the end.

I think the degree of this truck competition from the private sector is something that is there, and I think it is going to stay with us and get even

greater in the future. So I don't see that regulation of the for-hire trucks is going to do very much for the railways, because you are going to get this private truck competition all the time; you can't regulate them.

Q. Paragraph 15, pretty well the bottom of the first column, on page 6:

"Should a cost of service principle be
"adopted, charges of 'undue preference' and
"'unjust discrimination' would become almost
"passé as 'justice' in the matter of transport
"rates then becomes a matter of justice in
"terms of relative costs."

If your railway rate-making proposal based on the cost of service principle were adopted, would there be any necessity, in your opinion, to retain Section 322 of the Railway Act, or should that Section be repealed, that is the Section that deals with unjust discrimination and undue preference?

A. No, I don't see -- and I am not a lawyer, of course -- I can't see that that would mean that these two Sections would have to come out. I can still see that undue preference and unjust discrimination may well be a grievance to a shipper. What I have in mind now by saying it would become almost passé -- I mean if we had a cost of service type of rate-making, if rates became cost-oriented, I think regulators would possibly become more cost-minded, and when they were looking at the reasonableness of the rate or discrimination

or preference, then I think they would have in mind the rate structure we had set out, and that would be looked at in the light of costs.

Q. What would be the area, then, that undue preference or undue discrimination might be made and sustained?

A. Well, of course, we have the whole body of railway law which, of course, wouldn't be altered. I don't suggest any altering to it. But I think that now people come along and say that we have been unduly prejudiced; I am sure that our costs are lower, and it certainly happens sometimes, I do know -- our costs are certain lower; we are being unduly discriminated against. I think if we had a cost of service type of rate-making, then cost regulators might become more rate-minded. I am not saying they would throw the whole rate out, but decisions would be looked at in that light.

Q. In the allocation of constant costs, the value of service principle would still be operative and in that area there may be room for unjust discrimination and undue preference.

A. Yes. I can't see us throwing the two sections out.

Q. On page 9, paragraph 28, you are dealing there under a general heading as mentioned on page 8 of the "Breakdown of Monopoly", and in the first sentence of paragraph 28 you say:

"It is the contention of this brief that

"rate-making more closely associated with "the costs of providing services is more "suited to the conditions in which railways "find themselves today."

-- and you go on in that paragraph to say:

"The adoption of such rate-making would "preserve the economic health of the "railways, would result in greater technical "innovation",

and so on.

I think you would agree that unless the railways obtained more revenues as a result of your railway rate-making proposal than they otherwise would or as they now are, then the introduction of your proposal would not preserve their economic health and lead to these other benefits. Do you think that rate-making more closely associated with the costs of providing services would bring the railways more revenues?

MR. BRAZIER: May I ask Mr. Cooper, do you mean by that gross revenue or net revenue?

MR. COOPER: Gross revenues.

A. I think that if this was adopted for the reasons I stated before the recess, I think that the railways would become a very largely main line operator with the feeder and healthy feeder lines which are so necessary to it; and I can see the railways asserting their low cost advantages, I can see them attracting a great deal of traffic. Some of it admittedly would be away from trucks, long-haul trucks. I can see a great advancement in piggy-back service, for example, and in containers. There would be an awful lot of traffic attracted which the railways would be best suited to carry.

On the other side of the picture, I can see traffic being taken away from the railways, short-haul traffic, lightly-loading traffic possibly. Short-haul movements would on the other hand be left to the trucks, and the railways would be doing the job for which they are best-suited.

I am quite sure that their overall financial position would be very considerably improved if this were allowed to happen, if this came about.

Q. Mr. Brazier asked me if under the gross revenue, and I said in putting this question I have in mind gross revenues. Is your answer equally applicable to the net revenue position of the railways? Do you consider their net revenues would be increased as the result of the introduction of your railway rate-making proposal?

A. Most certainly, yes.

Q. How long before this process of closing of branch lines and these other developments that you have mentioned would come into effect so as to bring the improvements which you envisage for your railway rate-making proposal to fruition?

A. I did not actually recommend anything so specifically for branch lines so there is nothing to come into effect. I said that some vigorous policy should be urged and so on. That, of course, depends upon the thinking of the Board of Transport Commissioners, and I think they should really look at things and take vigorous action where possible. So it all depends on the rate of the Board of Transport Commissioners. Some of the other things -- is that what you meant? The one and one-third rule and the bridge subsidy, possibly that could be done fairly quickly. Other things in here, of course, would take a period of years.

I can quite see that we are not asking for anything overnight. Possibly pieces could come in one bit at a time, such as equalization, that would not be very difficult to stop any further progress towards equalization. Maybe the next thing to do, that proper cost studies have taken place, and these would be ---

Q. You are more or less now, may I suggest, dealing with the stepsthat would be taken to bring your proposal into effect?

A. Yes, I am not sure what you want.

Q. My question was rather, how long before the railways' rate-making position would be improved as

the result of the introduction of your system, from the time when it was first introduced?

A. I beg your pardon. I cannot say, of course, but it depends a lot on the policy of the Board of Transport Commissioners in abandonment cases. I think that is the first thing.

Then I cannot say, I think there will be fairly good prospects of something, an improved position coming fairly quickly.

Q. Now, you referred this morning to the Turgeon Report, and I should like to direct your attention to page 119 of the Report "Conclusions and Recommendations" and the Report states with reference to the proposals submitted by British Columbia, as follows:

"It might indeed, lead to much
"higher rates than at present being
"charged on low-valued primary commodities.
"It is important that these rates should be
"kept relatively low. Shippers have come
"to depend upon them and it would be a dangerous
"experiment to upset the present value of
"service principle in favour of the untried
"cost of service principle."

Now, I have particular reference in that quotation to the words "It might indeed lead to much higher rates than at

present being charged on low-valued primary commodities." I should like you to comment on that statement with reference to the proposal you now put forward.

A. Well, the thing is, as Mr. Brazier said this morning, I think it was Mr. Turgeon who said they wished they had another look at it, and very respectfully ---

Q. I suppose that is one way of getting that into evidence.

MR. SINCLAIR: Of course, all I can say is that Mr.Turgeon should have written a third report.

THE CHAIRMAN: That is hearsay, I think.

MR. SINCLAIR: Because his second report, as far as we were concerned, was much better than the first one, and I am sure the third one would have been better than the second one.

MR. FRAWLEY: You don't expect me to agree to the second one being better?

MR. COOPER: Q. I am sorry, Mr.Hughes. Perhaps you might go on.

A. I did not realize I was doing things I should not do there.

Q. That is quite all right.

A. Very respectfully to the Turgeon Commission in the job that they did and in the light of the information they had in mind at the time, I think they were under a misconception. No traffic is being subsidized, including these primary commodities, if it pays its out-of-pocket costs.

Now then, low rates of primary commodities will very often provide high revenues, it will provide higher revenues than if the rates were kept high.

Now then, the Inter-State Commerce Commission, I think we have had this before, the distribution of rail revenue contribution by commodity groups, 1957, Statement 2-59, it points out in the first page very graphically, it points out that out of the 12 squares here which represent commodities moving in official, south and west, that out of the 9 squares (there are 9 squares there) it shows that the primary commodities -- sorry, 6 primary commodities -- are contributing the most to the transportation burden.

I would just like to read those out. Coal, 169.2 million in official territory, a very big contributor; in the south coal again 15.8 million; in the west lumber 24.2 million; fertilizers 8.2 million; wheat 100 million. Sorry, there are 5 there out of the 9 squares.

So that this just shows, to my mind, that the primary commodities, even though they have low rates here in the United States, even though they may have low rates when they are primary commodities, they in fact do actually represent a big contribution to the burden. Nobody is subsidized, that is what I mean, and because the thing is low-rated does not mean to say it is not a very big contributor to the railway revenue, and certainly nobody is subsidizing them because they are not being carried at less than out-of-pocket costs.

I do not think in the Turgeon Commission, I do not think that would be the fact at all. I cannot see rates on primary commodities going up at all because there is no real subsidy from other segments of traffic. The very volume of the so-called low-valued traffic would bring in a great deal of contribution for the revenue of the railway if it was over out-of-pocket costs.

Q. Of course, the difficulty, I think, that perhaps some people might be under with respect to thewhole of such rate-making proposal, is that you put maxima on captive traffic. You cannot go above fully-distributed cost. You put a lower limit as out-of-pocket costs, and if the railways need more revenue and cannot exceed the maxima, then does it not follow that they must go above and continue to go above the minima, and if they cannot do that and have not the freedom to go above the maxima, where are they going to get their necessary revenues?

A. That is a good question. Well, I first of all was looking around for, well, what they get revenue from. Why set, how do we set maxima rates?

Now then, we can look at constant costs, I think, as a block of expenses which cannot be assigned to any particular traffic. We look at this big block of costs, these constant costs.

Now, the fully-distributed costs are very arbitrary indeed. It all depends on how you distribute it. You can distribute it on a ton-mile basis; you

can distribute on a proportion of variable cost; you can just do it on the number of passengers boarded and things like that: so fully-distributed cost is a very arbitrary figure indeed, and it is very meaningless.

It is well-known that if traffic is carried at something more than its out-of-pocket cost, then it is a contribution to this total overhead burden. The more the traffic carried, then the more is the burden, if the rates are above out-of-pocket costs. The lower the contribution from each unit of traffic, often the more is the total contribution.

If you have a low contribution from each unit of traffic, the total contribution to this body of constant expenses may be very great.

For example, if you take, say, 100 tons of traffic at $5 a ton over out-of-pocket costs, then the contribution to this body of constant expenses is $500. If you take 130 tons at only $4 a ton, then you can get a contribution to these constant expenses of $520, and the rates for everybody can come down. There is less overhead to be borne for everybody.

If in fact the rates on some traffic are moved up above the so-called (and I put this in inverted commas) the "fully allocated costs" then the total contribution to this large body of constant expenses, which are there anyway, may in fact be less.

For example, to carry on from my previous one, if you take 50 tons carried, because the rate is now high, at $6 a ton, then you only get $300 contribution

to the constant expenses. I think this is shown up quite well in the burden study where coal is the biggest contributor to overhead, but it does not in fact cover its total cost. The railways, I think, when they put in that cost study, they did not ask for any rate above the fully allocated cost, and they did not evidently think that any burden was thereby being placed on other traffic. They did not want anything over the fully allocated cost. Nobody was worried about the burden being placed on other traffic there. So I do not see what the difference is.

MR. MAURO: We cannot hear.

THE WITNESS: The railways did not ask in the study where this conclusion was.

MR. COOPER: Q. You refer to the grain study.

A. The grain study. They did not ask for any distribution over and above the fully allocated costs. There may have been a few cents and so on, but they did not think any burden was being placed on other traffic. Nobody mentioned it.

Q. But included in the fully allocated cost is cost of money and many other factors which provide for a reasonable profit; is that correct?

A. Yes, I agree with you.

Q. Is this limit you have set on captive traffic, the fully allocated cost limit, rigid in your thinking with respect to your railway rate-making proposal? Why could not it go to one and a half times

fully allocated costs in this case?

A. I really don't see any ---

Q. Why couldn't it go twice?

A. I really do not see any necessity for it today. As I say, it is a statistical allocation here. I do not see any reason why it should go above fully allocated costs. I do not see why this non-competitive traffic should have to bear a great deal of burden.

I did not get this idea on my own of fully allocated costs, or at the maxima. I got it from Mr. Stenason's book. I call it Mr. Stenason's book. I know he had a great deal to do with it. This is where I got the idea from. If you like to know where I got it from, I will tell you.

Q. You might give us the answers.

A. Page 247.

Q. Is this chapter written by Mr. Stenason?

A. Well, I don't know, but he contributed to the book and I am sure he agrees with what is in here anyway. I think it is an excellent book. This is what he says.

"Clearly, a railroad would occupy a monopoly "position in the provision of piggyback "line-haul services except when confronted by "direct competition from another railroad. Even "such competition, however, is likely to be of "the restrained variety that usually arises when "'competition is among the few.' Consequently, "regulatory control over the maximum rates on

"these services should be retained; further- "more, to make these rates consistent with the "other policies advocated here, they should be "cost-oriented, being only remunerative enough "to provide the normal 'fair return' on the "facilities involved.

"An argument for some residual rate "regulation applies almost as forcefully to a "number of bulk commodity movements; in "bulk commodities the situation is different "than in high-value goods, but different only "in degree and not in basic substance. "When bulk commodities are technologically "capable of pipeline movement or in geographic "areas where water transportation is a real "alternative, the situation is essentially "competitive and identical with that just "outlined for most high-value commodities. "By contrast, the bulk commodity situation "differs substantially from that of high- "value commodities for those bulk commodities "which must be moved over land and must be "moved by either railroad or pipeline, that is, "cannot be moved economically by both. It "should be noted, however, that actual "practice in such situations already comes much "closer to achieving an optimum resource "allocation because the present bulk commodity "rate structure is reasonably reflective of

[illegible]

"costs, largely because market competition "places more restraints on transport rates "in these sectors.

"For many of the noncompetitive bulk "commodities that now move by rail (for example, "grains, livestock) truck competition has "become increasingly real, but this competi- "tion is insufficient as a rule to deny the "railroads something of a partial monopoly "in such traffic. Therefore, just as in the "case of piggyback services, the previous "recommendation of a general relaxation in "rate regulation should not apply to the "carriage of these noncompetitive rail bulk "commodities and the power to limit maximum "rail rates in such cases must be retained by "regulatory agencies. In actuality, moreover, "some rail rates in these sectors may be "unjustifiably high today."

(Page 13535 follows.)

Then he goes on to say at pages 249 and 250:

"There remains the question of whether a regulatory need to set minimum rates still exists. The main economic function of minimum rates has in the past been either to protect excess, unneeded capacity, or to prevent competition from eliminating specific returns in excess of costs that are needed to cover losses incurred elsewhere. A lesser function has been to prevent traffic from being uneconomically usurped by a carrier with higher average costs but lower marginal costs than the principal competing transportation. The latter situation is most likely to arise when substantial overhead costs exist, a condition truest for the railroads and pipelines of all the carriers here under analysis. The protection of unneeded capacity from economic elimination has never been justified, of course, and a national policy should aim at reducing and eventually eliminating most uneconomic or loss operations. If such a policy is adopted, the need should cease, in turn, for returns in excess of total costs in other areas."

Then, going on to the bottom of page 250:

"In particular the end of attaining a competitive, cost-oriented rate structure would be best served by eliminating existing rate bureaus and similar agencies for cartelizing transportation activities".

That was his comment there.

Now then, Dr. Solandt also had the same thing in mind when he gave a speech out in Vancouver at one time on maximum rate control ---

MR. SINCLAIR: There are some other parts of the book which should be read. When you read one part you should read other parts which help to explain the statements, and you should read them at the same time. I know that Professor Hughes was brought up in the same school that I was, and at page 181 ---

MR. MAURO: Which school was that?

MR. SINCLAIR: The school of fairness.

MR. MAURO: You attended that?

MR. SINCLAIR: It is at pages 181 and 182.

THE WITNESS:

"...that value-of-service rate-making as now practiced is both undesirable and unnecessary."

MR. SINCLAIR: Keep on reading.

THE WITNESS:

"The argument for desirability of value-of-service rate-making rests in part

on the argument that low rates on commodities which have a high elasticity of demand are a net gain to society. Railroads, so this argument goes, have a high fixed cost. So long as the rate covers the additional cost of carrying the traffic, it represents no burden on either the carrier or other shippers."

That is what I have been saying all along, is it not?

MR. SINCLAIR: It goes on:

"As Professor Locklin states..."

THE WITNESS:

"As Professor Locklin states: 'Preferential (driscriminatory) rates relieve rather than burden other traffic if two conditions are fulfilled. These are (1) that the rate must more than cover the direct costs: and (2) that the traffic will not move at higher rates.'"

Do you wish me to read any more?

MR. SINCLAIR: Just the next sentence.

THE WITNESS:

"The logic here is impeccable and one must agree with its essential truths".

MR. MAURO: That is it.

MR. COOPER Q: In any event, Mr. Hughes, is this upper limit rigidly fixed so that if your

railway rate-making proposal were considered for adoption that upper limit could not be increased without destroying the effectiveness of your whole proposal?

A. No, I cannot see it being increased without an increase in the corresponding out-of-pocket costs. I cannot quite see that because the shipper is captive he should have to bear all the costs of the railway burden, and so on. I cannot see that.

Q. Let us say that the only reason for raising the upper limit is to enable the railways to get enough revenues to keep them in proper financial condition and in a state of financial health. Let us suppose that in order to do that it was necessary to have maxima greater than you suggest. Under those circumstances, would there be any objection on your part? Do you think it would destroy the whole rate-making proposal you are putting forward if those maxima were raised?

A. No, I do not. We are fairly flexible in this, and we would, of course, have to -- somebody or some regulatory body would have to know a great deal more about costs than is known now. We are not absolutely dogmatic on it, but we say a rate does not have to be very high compared with total contribution, such as we can see in the United States.

Q. You are not inflexible on those rates in regard to captive traffic?

A. No, we are not inflexible on anything in the brief, and I might say that Dr. Solandt said the same thing in his speech.

Q. What is that speech? Have you identified it yet?

A. This is a speech called "Frugality in Transportation" which was made by Dr. Solandt, the vice-president of the C.N.R. at the University of British Columbia, on February 13, 1958.

Q. Thank you. At page 9 in paragraph 30 you state that the U.S. Department of Commerce is noting complacency on the part of American railroads, and the quote goes on,

> "But so far as appears, much loss in the freight traffic is not the result of regulatory requirement but of a failure of the carriers to come forward with appropriate proposals for adjustment. Worse, they show a tendency to expand the area of unprofitable rates and activity to solicit business that can only be handled at a loss."

Is it your view that this situation is true also in Canada today, that the railways show a tendency to expand the area of unprofitable rates and activity to solicit business that can only be handled at a loss?

A. Well, this is, of course, true of the

United States railroads, or, the Department of Commerce sees it like that. I can see that it is true in Canada in one particular area, but I will not go so far as to say that they actually go out to solicit business that can only be handled at a loss. I say they go and put rates on the traffic which can only be handled at an out-of-pocket loss.

Q. Have you any examples of that?

A. Yes,I think Mr. Edsforth gave us an example of that in volume 13 at page 1786. I could read it to you, or give you the gist of it.

Q. Perhaps you could just mention the subject of it.

A. This was on statutory Crows Nest rates and Mr. Brazier asked Mr. Edsforth how many commodities were in the original agreement, and Mr. Edsforth said he thought it was grain and flour. Then, Mr. Edsforth was asked how many commodities are in the present structure, and he said there are something like 37. Actually, I think when I saw the list myself there were 50 odd, but I am not just sure. However, Mr. Edsforth agreed there was nothing that was statutory about putting these rates on to these other commodities; in fact, the railway had done it voluntarily, and this is the gist of what he said at page 1790:

"Q. Included in that -- I don't think I have a complete list here, but, for instance, there are breakfast foods and cereals, are

there not, uncooked in bags?

A. Yes, uncooked. That would be your rolled oatmeal in your original tariff.

Q. Surely you wouldn't call some of our modern breakfast foods like "Pep" and other products ---

THE ACTING CHAIRMAN: Oatmeal would be in a different position to Rice Krispies.

MR. BRAZIER: Q. Now, all those sort of products are included today.

A. The uncooked ones, not the cooked ones.

Q. Uncooked?

A. Yes. That would take in Corn Flakes, or anything like that".

So Corn Flakes are carried, and there is no law to say they have go to be carried. There are no instances in the present tariffs.

Q. You say there are no statutory requirements to extend the list as you have indicated it has been extended. Have you any reference for that? Was that dealt with in the evidence before by Mr. Edsforth?

A. This was dealt with by Mr. Edsforth.

Q. At what page of the transcript?

A. Pages 1786 to 1796 .

Q. Does he say there it was done voluntarily? Perhaps the Commission can check for themselves.

A. I think that was the purport of it,

but we know it is not done by statute. We know that they are not carrying Rice Krispies because there is a law which says they have to carry Rice Krispies.

MR. COOPER: Well, I will leave that for my friend, Mr. Sinclair.

MR. FRAWLEY: Would that be Rice Krispies for export?

MR. BRAZIER: Not to Fort William.

THE WITNESS: I am sorry; this is Corn Flakes. I do not think I should have said "Rice Krispies", but it is stuff like that that I am talking about.

MR. FRAWLEY: They are made in the east.

MR. SINCLAIR: The only point is that there is no statutory element in it. I want to know if Mr. Edsforth did say that. I do not know where Mr. Edsforth said that.

MR. COOPER: I doubt very much if Mr. Hughes knows at the moment, but I suggest that my friend, Mr. Sinclair, can check it himself and meet it when the time comes.

THE CHAIRMAN: Yes.

MR. COOPER Q: Would you look at the first sentence in paragraph 39 on page 11:

> "The pricing of transport services on a cost basis automatically ensures coordination of transportation".

Does not this involve all media of transportation having rate structures based on cost?

A. Yes, it does.

Q. Well, then, unless you have all the media of transportation with rate structures based on cost how are you going to bring about co-ordination of transportation, and, in fact, ensure it, as you have used that expression in paragraph 39?

A. As soon as you get the railways basing their rates on cost then I think it is automatic that the truckers would follow. The pipelines have no reason now to base their rates on anything other than cost. Shipping lines on the lakes follow the railway pattern. I think as soon as you get the railways basing their rates on cost you will also get a sympathetic movement in the other transportation agencies and they will also base their rates on their costs to assert their own inherent advantages.

Q. You are suggesting then, that if the railways' rates are based on cost, other media of transportation will follow and you will ensure ---

A. At least, where they are competitive they will. Where there is competition between the agencies then they will automatically follow.

Q. --- coordination of transportation? That is the position you take?

A. Yes.

Q. I am going to move on, Mr. Hughes, to chapter 7, and to page 21, paragraph 76. You are dealing there with empty return car movements, and

you say:

"Whether cars normally return empty or otherwise on a particular route or because of some particular traffic has a great bearing on costs. If there normally a 50-per-cent empty return factor, out-of-pocket costs will be , other things being equal, twice as high as if cars were fully loaded each way."

Is that second sentence right?

A. No, I should have put in the figure of 100 per cent there.

Q. "50-per-cent" should be "100-per-cent"?

A. Yes.

MR. SINCLAIR: In what paragraph is that?

MR. COOPER: Paragraph 76 on page 21.

Q. At page 22 you deal with the subject of recovery of overhead costs, and you mention three methods of distribution of overheads, and they are listed under (a), (b) and (c), and (c) is distribution according to the value of service, and in paragraph 81 you say:

"The method is infinitely superior, on all counts, to the other two."

I take it what you are saying is that the method of distribution according to the value of service is infinitely superior to the other two?

A. Yes, that is what I meant to say.

Q. Is not this the method presently used by the railways?

A. No, I would not say it was. The railways at present, of course, have the classification, which is very largely based, as I have said, on the value of the commodity. Not only do they have class rates based on this classification, but they also have commodity rates based on this classification, and I think this is well borne out by the rates I have put in the first part of the brief. The class and related rates are related to the value of the commodity at present, whereas the system in Part 2 would not do that.

(13550 follows)

Also the railways at present may not be maximizing their receipts as to what the traffic can bear; they may not be maximizing their receipts on some traffic. One particular instance, of course, is corn flakes, possibly rice krispies, and so on; and also the present system does not allow for traffic to be carried above out-of-pocket costs. Our system would make it illegal for the railways to carry anything at less than out-of-pocket costs. There is nothing to stop the railways going into competition today and providing a service at predatory pricing and putting a competitor out of business.

COMMISSIONER MANN: Mr. Hughes, did I understand you to say that at present the railways are illegally allowed to make rates at below out-of-pocket costs?

THE WITNESS: On rice krispies.

COMMISSIONER MANN: On any commodity. Do you think the Board allows the railways to make rates below out-of-pocket costs?

THE WITNESS: Yes, I think there is such traffic carried at out-of-pocket costs.

COMMISSIONER MANN: And if the Board found such a rate, would the Board discontinue it or make the railways withdraw it?

THE WITNESS: It may be if they had found it.

MR. COOPER: Q. If it was carried at out-of-pocket costs, I understood you to have in mind on that point the extra products which had been voluntarily

given the benefit or you say given the benefit of statutory rates.

A. Yes.

Q. That is what you had in mind, but you have now gone further in answer to Commissioner Mann's question, I believe.

A. Yes. I would like to backtrack a little bit on what I said. I said the railways could engage in predatory pricing. I had forgotten for a minute that the railways' rates had to be compensatory. I think there are instances where railroads do carry traffic at less than out-of-pocket costs. I think in the Turgeon Commission, it was pointed out in one brief by the railways, in their Part 1, that some lcl freight, they thought, was carried at less than out-of-pocket costs. They also said in this brief -- I will give you the reference. The At. and East rates are mentioned on page 71 to 78, Submission of C.P.R. to the Royal Commission on Transportation, Part 1.

THE CHAIRMAN: That is the Turgeon Commission?

THE WITNESS: Turgeon Commission, yes. Some of the lcl traffic -- it is inferred that it is not compensatory. It says in one paragraph on page 84:

"While the average loading per way-freight
"cars is substantially lower" --

and he is talking about lcl traffic --

"than the loading per car of straight mer-
"chandise cars or carload traffic and the

"earnings thereon may be considered as non-
"compensatory, the service these cars perform
"is of great importance to the communities
"they serve . . . "

I think here they are inferring that these rates may be actually non-compensatory, may be carrying out-of-pocket losses. There may be agreed charges, there may be --

MR. HUME: Which Turgeon Commission, the first one or --- ?

THE WITNESS: The first one, 1949-51.

THE CHAIRMAN: We will adjourn until two o'clock tomorrow afternoon.

---Adjournment.

Hon. C. P. McTague

ROYAL COMMISSION

ON

TRANSPORTATION

HEARINGS

HELD AT

OTTAWA

VOLUME No.: 77

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ROYAL COMMISSION ON TRANSPORTATION

Proceedings of hearings held in the Court Room, Board of Tansport Commissioners Offices, Ottawa, Ontario, on the 7th day of June, 1960.

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E R R A T A

VOLUME 77

Pages 13598 to 13607 (inclusive)

Shoulder note: Delete: "Hughes, cr-ex (Cooper)"

Substitute: "Hughes, cr-ex (Mauro)"

Ottawa, Ontario,
Tuesday,
June 7, 1960.

---On commencing at 2.00 p.m.

THE CHAIRMAN: Order, please. Today we will sit until five o'clock.

CROSS-EXAMINATION BY MR. COOPER (Cont'd):

Q. Mr. Hughes, yesterday you were asked a question at page 13550 of the record. Commissioner Mann said:

"Mr. Hughes, did I understand you to say that at present the railways are illegally allowed to make rates at below out-of-pocket costs?"

And then certain discussion followed from that question, and at page 13552 you were, I believe, in the process of answering the question but you had not completed your answer when adjournment took place. Is there anything further you wish to add to what is in the record with respect to the question that was raised?

A. Yes, I think so, Mr. Cooper. I hadn't quite finished the answer. I was speaking about the C.P.R. brief to the Turgeon Commission, Part I, 1949, and I had already mentioned that the suspect areas pointed out by the C.P.R. in 1949 were the way freight trains to do with l.c.l. traffic and the Ac. and east grain rates; and now I pass to page 96 of the C.P.R. submission, and this is what it says at page 96:

"Alberta coal to Ontario points. Earlier in this submission reference was made to a non-compensatory rate known as the At. and East grain rates. There is another competitive rate which is also non-compensatory and that is the rate on Alberta coal to Ontario points."

That is one suspect area. There are other suspect areas, one of which would be the passenger service, and I think there has been talk in these hearings so far that the passenger service is running at a deficit.

In the transcript, Volume 19, page 2747, Dr. Edwards said:

"The passenger train service revenues do not cover the total variable cost for the passenger train service."

This passenger train service is one of these areas where we are talking about in paragraph 30 of the British Columbia submission, on page 9, and this is directly related to the question -- a tendency to expand the area of unprofitable rates and activity to solicit passengers that can only be handled at a loss. Now, passenger service is to me an obvious area in which this is done.

We get evidence in this Commission at this time that some branch lines are also suspect areas. I am not saying that traffic on branch lines is actively solicited, but at least it is a suspect deficit area.

Mr. Stenason at Volume 69 of the transcript, page 12250, said this:

"As I said earlier, I have not analysed all the branch lines of Canadian Pacific. I suspect there are individual branch lines on Canadian Pacific which are operated at a deficit."

These are specific instances that I have, Mr. Cooper. There may be others that I don't know about.

Q. That is all, then, you wish to add to your answer of yesterday to the question to which I referred?

A. Yes.

Q. Would you turn, Mr. Hughes, to page 26 of Part II of the submission and paragraph 95 on that page. It is stated in that paragraph, and I am quoting:

"It is urged, therefore, that rates should be allowed to go lower than necessary to meet competition, but only to the level which will maximize the railways' receipts on a particular class of traffic."

Would you explain just what you mean by that sentence?

A. Yes. This paragraph 95 and the one immediately preceding it, 94, both mention that rates should not be allowed to go -- rates should be allowed to go lower than necessary to meet competition, but only to the level which will maximize the railways' receipts. Now, this is somewhat misleading the way it is written, and as I read it now. What I mean is that the Board of Transport Commissioners should not restrict railways to put rates right down to out-of-pocket costs

if they want to, and they should not prevent the railways putting rates as high as they want except for captive traffic, which I suggested should be fully allocated costs. Within this minima the railways should be allowed to do what they want, and when I say rates should be allowed to go only to the level which will maximize the railways' receipts, I mean by this that I am urging the railways to do this. I don't mean the Board should allow this; I mean the railways themselves should allow them to go to the level which will maximize their receipts.

Q. Would that involve an amendment of section 334 of the Railway Act?

A. Yes. Section 334 of the Railway Act as far as I can see it, paragraph 2, subsection (c) --

> "Rates are not lower than necessary to meet the competition."

That subsection, as I see it, would have to be deleted from the Act, repealed.

Q. Would you turn to chapter 8 -- Proposals for a New Rate Structure, paragraph 100. This is the first paragraph of chapter 8. You state there four types of rates schedules as being the basis of the structure, the first two of which are minimum rate schedules for all carload traffic, and maximum rate schedules for all carload "captive" traffic. I take it that the minimum schedules for all carload traffic and the maximum rate schedules for all carload of their "captive" traffic will be published under the

proposals you are putting forward and thus become available to the railways' competitors?

A. Yes.

Q. Why should the schedules not be withheld from publication? Why should they be made available to everybody?

A. Well, they should be published, I think, because interested parties -- and, of course, this includes truckers, and another interested party is a captive shipper -- these parties want to be certain that no traffic is carried by the railways at less than out-of-pocket costs, because in the one case the trucker would believe it was predatory pricing, and in the case of the captive shippers, that obviously they are being burdened by out-of-pocket costs which the railways want to or do incur, probably unwittingly, on this captive traffic. Now, I don't envisage that if the Board of Transport Commissioners Cost Section was set out or some other cost section was incorporated into the regulation of the railways -- I don't see that publication of minimum schedules would be something that we would be inflexible about. I think if they were published and there was access to the railways' costs, then I would not be against not publishing the railways' schedules.

Q. Whether it is published or not depends on whether there is a strong cost-finding section attached to or part of the Board of Transport Commissioners?

A. Yes. If there is no cost section set out -- if anybody turns to them, the Board or some other place, then so that the captive shipper is sure that nothing is being put onto him and he is not being run out of business by the railways, which could conceivably happen as traffic gets heavier.

Q. I turn to page 29 where you have a distance factor table. You put the rating at the top, the carload classification table, which is taken from your Carload Classification table on page 28. Under that you have got cents per 100 pounds, and you show distances 100 to 199 miles and 200 to 299 miles. Is this distance factor rating uniform for all Canada?

A. Yes; and the reason is this, because other cost differences between one region and another, one route and another, one type of commodity as against another type of commodity going over a different route must, I think, be taken into account in the other arbitraries, the terminal group and the route group, and also in the classification itself.

THE CHAIRMAN: This would apply to Newfoundland?

THE WITNESS: Yes, sir.

MR. COOPER: Q. Paragraph 105, also on page 29, deals with terminal arbitraries, and I take it that if a commodity has to go through a number of terminals which are high cost because they haven't been modernized, or for some other reason, then the movement of that commodity would be at a disadvantage

compared with a like commodity which, on its way to the market, would go through terminals which were low cost terminals?

A. Yes. We don't want to carry any commodities at less than the out-of-pocket cost, and if there is a high cost movement, we think that high cost should be related in the rate the shipper pays.

Q. That prevails in your whole conception of cost and everything else must yield to it; is that correct?

A. I am not going to be categorical about it. There may be matters of national interest. I could not be categorical about it.

Q. Surely apart from questions of national interest, which at the moment you are not prepared to specify, cost would be the dominant factor in all cases?

A. Yes, it would be the dominant factor.

Q. At page 30, paragraphs 112 and 113, you refer to what I may call reclassifications of traffic into the captive class or from the captive class into the other class. Now, would you anticipate a large number of applications to the Board under paragraphs 112 and 113 to change categories of traffic from captive to non-captive and the other way about?

A. I can't see many applications to the Board from the shipper to have his traffic classed as captive, because I think competition is just pushing the thing the other way. I think we are getting more

and more traffic into the competitive rates now, and I think once we get the initial -- get the thing going initially, I can't see any more applications. There may be one or two; some trucking firm may have to go out of business, or something like that, and then there may be an application. On the other side, if the railways wanted to get traffic classed as non-captive, again I can't see any applications coming up. The only reason I think the railways would want to reclassify this traffic would be to tidy up their books so that they wouldn't have to publish the maximum schedules; I think the maximum schedules would become paper rates.

Q. On the other hand, there is nothing static about this captive class, is there, because it depends on competition which may be absent one day and may appear the next day?

A. Well, of course, for a captive shipper to be captive there must be no reasonable competition, and by no reasonable competition, the railways would have to show that the competition was not sporadic, or the other way round, that the competition was not there and the competition was only sporadic. That is not day by day competition; it is competition which is really there, if you have traffic classified as competitive traffic. It isn't day to day competition, it is something that is always there.

Q. I understand it is not day to day competition, but, on the other hand, something which is captive one week may be non-captive next week; there

may be changes from captive to non-captive class?

A. I can't envisage such a situation at all.

Q. The only point I am making is that there is nothing really static about this captive class, because it depends on competition which may appear at any time?

A Yes, there is nothing static about it. I envisage a great movement in the next few years, practically all traffic will become competitive, but there will be certain areas which will never become competitive, but most of it will.

Q. When you are referring to competition you are referring to existing competition and not potential competition?

A. Where are you looking at particularly?

Q. Well, your definition of captive traffic is traffic for which there is no reasonable competition. I take it that means no reasonable actual or existing competition?

A. That is what I am meaning.

Q. You are not concerned there with potential; you are not reading from the word "competition" any potentiality with respect to it?

A. No. I am talking about actual competition.

Q. At page 31, paragraph 119, you state right at the bottom of the page:

"General horizontal percentage increases would not be in accordance with the proposed

principles of rate making."

You may have already told the Commission this, but I believe the situation would be under your proposal that general horizontal percentage increases would be eliminated and become a thing of the past?

A. Geneal horizontal percentage increases would be eliminated, yes.

Q. What would be the procedure that would be followed if the railways required additional revenues from rate increases?

A. It may be better if you look at the suggested tables on page 29 as I answer you.

Q. Yes.

(Page 13568 follows)

P/1d

A. And the railways want a rate increase because something has gone up, probably fuel oil or something like that, or, better still, a general increase in wages of trainmen or general labour like that.

Now, this would be a factor where the railways would obviously want a rate increase, so that they would have to go along to the Board with an analysis of the figures of where this wage increase is bearing on. Is it in the terminal? It may be some of it obviously in the terminals. I doubt whether there would be any particular amendment to the routes here because labour is employed on all the routes.

The distance factor, there may be costs there that may go and these would be broken up and simply an addition put into the distance factor in the cents per hundred lbs. -- instead of 20 cents, then the proportions that should go on to cover the whole wage increase. It may just have to be amended to, say, 21 cents, 19 cents, 17 cents.

If terminal costs have gone up for any reason, then we will get an increase in the dollars per carload, but I cannot imagine that there would be frequent changes. I do not envisage frequent changes like this. I can imagine wage increases and this would be one occasion. Other occasions may happen when the price of fuel oil goes up or the price of ties and so on, but I do not envisage continual revisions of this. I think that the scale should be set up with an eye to

the future, for the foreseeable future in the cost situation, but the whole thing would be that the cost increase for the terminal, whether it was labour or fuel oil or cost of ties or ballast, the cost increases would be put where they belong, either in the terminal group or in the distance factor or possibly in the route group. The cost will be brought home to rest where it belongs.

Q. You may have already touched on this point before, Mr. Hughes, in your evidence. I think you have. I nevertheless want to put this question to you and, even at the expense of some repetition of what you have already said, would you please answer it for the information of the Commission. The question is this: what are the steps by which your rate-making proposal would be brought into effect?

A. I think the answer is very largely on page 34, paragraph 132. I say that the first step, as I see it, would be that artificialities such as the one and one-third rule, something should first be done about that. We want it cancelling. Another artificiality, of course, is equalization. I think that would be, any further progress towards equalization, would be another of the first things to be done.

I think then as railway studies get on, and we know the railways have a lot of cost studies already done, they supply them to the traffic men all the time, then I think that maximum rates should be possible for captive traffic, at least in the worst class there

and then possibly lcl and carload scales could be done after that.

But the whole process, apart from further movements towards equalization and possibly the one and one-third rule, that may take a while, but the whole process, I do not imagine to be coming in overnight. We do not want another Royal Commission on Transportation, and we are trying to take a long-term look at things.

THE CHAIRMAN: How long would the changeover take?

THE WITNESS: I imagine a good many years, I should say three, four or five years. I am not looking for anything overnight, Mr. Chairman. Youcan do your lcl and passenger scale just as soon as the railways -- I don't want to overburden anybody with work but as soon as they could get down to it and find out more about their own costs.

MR. COOPER: Q. Mr. Hughes, you have throughout the Submission referred in several places to location of industry. What effect, if any, would the implementation of your rate-making proposal have on the re-location of existing industries and location of new industries? When I use that word "industries" in this question, I mean secondary manufacturing industries free to locate in areas where transportation costs would be most favourable.

A. "Industries" means an awful lot of things. We can take anything into the meaning of industry. I like to split industry up into at least

three classes. First, of course, would be the extractive industries, and these would be industries such as fishing, any of the industries based on fishing, such as fish canning. Other ones would be apple growing and industries based on apple growing, the making of cider or apple juice. Agriculture, canning tomatoes, that part of industry, based on the extraction of things either from the sea or lakes or agriculture or the forests, saw mills and so on.

No matter what the transportation prices were, that industry could not be re-located. You have to have a saw mill near to where the trees grow, because you cannot transport logs hundreds of miles, thousands of miles and saw them up and throw all the waste products away. So extractive industries would not have their location changed.

There is another type of industry which I call the ubiquitous type of industry, and this is one where raw materials, the main raw material is located in every part of the country, and one of those examples would be water. Again I refer to beer or pepsi-cola or some soft drink like that. It is just not economical to transport water all over Canada in bottles. Even the best beer or the best cola or something like that is about 99½ per cent water, so you are not going to transport water all over Canada. You might as well get the other raw materials and then make the commodity.

Another one of these ubiquitous industries is brick-making. You can get clay a lot of places, so

you are not going to transport bricks all over the place. You can transport the colouring or whatever they use in bricks and get the clay locally.

So extractive industries and ubiquitous industries just could not be changed by this type of proposal.

There is a third type of industry and this is the one you refer to as secondary manufacturing. Very often in secondary manufacturing the transport costs are not a high proportion of the selling price. An example, I should think, would be tires, electrical apparatus, quite a few things, where transportation costs is not a high proportion of the selling price. If the transport cost is not a high proportion of the selling price, it very often happens that other things are more important than transport costs. Other things would be labour or the price of labour, the price of electric power and other kinds of power. There may be other things, there may be the rent site, there may be all kinds of other associated industries in the area which give greater economies than shifting the whole factory would give to the industry because of any freight rate change.

I cannot see that any existing secondary manufacturing industry would change, because other things are less important than transportation. Usually in this kind of industry there is very often a whole area of other things grown up around it, and they are not going to change. Very often also with this type of

industry, whatever the freight rates are, whether they are brought down through this proposal or not, there will always be high freight rates to the Maritimes, there will always be high freight rates to British Columbia, some parts of Alberta and Manitoba and so on.

So it is always going to become somebody to set up a factory under this umbrella, and there will always be this secondary manufacturing set-up under a freight rate umbrella, no matter how much you bring the freight rates down or no matter how much you alter them.

On the whole I really cannot see that this proposal would have any great change on the location of industry at all.

Q. You do not think that this proposal would have the effect of causing secondary manufacturing industries which are now located, let us say, in the western provinces under the umbrella to move into Central Canada, or the loss of new industries which might under our present freight rate structure locate in, say, Western Canada.

A. Well, I would like to put it further than that and I would say that in those areas, on these main line routes, Calgary, Edmonton, Winnipeg and so on, I can say, just as very low cost routes, that are now paying higher prices than they should be, they should have lower transportation prices than they now have because they want the benefit of low cost operation

We would get industry moving to Winnipeg, Alberta, British Columbia and the Maritimes up there on these good, well-loading routes.

COMMISSIONER MANN: Mr. Hughes, I have a little difficulty here. If the movement, say, from Toronto to Winnipeg on secondary manufacture takes place in a lower rate because of the cost base structure, then to the extent that freight rates are a locational factor, to that extent it would not pay to have the secondary industry in Winnipeg. It would pay particularly in industries where there is any benefit of economy of scale to have a single location industry rather than a multi-location industry. The effect -- I would like you to comment on that -- would perhaps be the opposite.

A. I see your point there, and of course it all depends on the type of industry that we are talking about, but to the extent that transportation costs are the all-important thing, then there may be some flow there, but very often the factory will go up to Winnipeg because the meat is there and they set up a meat-packing plant and they will want low costs there. Or they will go because they want to set up a woollen textile factory and they like the girls that work there, they pay lower wages probably there than they do in Toronto or something like that.

But it is really impossible to -- I cannot see any change under this. I cannot see any existing

industry changing, and I can see that people want to go out to these low cost mainline routes to get out of the other factors, and I really cannot see any change, and if there is any change at all I think it is going to the benefit of the provinces on the good routes.

THE CHAIRMAN: Don't you think there is the danger of centralizing industry?

A. I cannot see that it would centralize anything, Mr. Chairman, I cannot see that at all. The position as we have it now, we are getting more and more competition. I do not think we are seeing any trend to centralization. I think we are still getting our factories and so on out in the Prairies and British Columbia.

To argue for higher freight rates because we want local industry all seems to me to be a false argument. We often get people at home arguing for high freight rates, because they want industries there that are protected under tariff, but the disadvantage to the whole people in the area is much greater than the advantage to those particular few who have a candy factory. I do not think there is any danger of centralization.

THE CHAIRMAN: Well, high freight rates have built up some secondary industries in B.C., has it not?

A. It has done, but it has not built up very much. Most of our industries still related to the forests and the fisheries, but it has not built up very

much secondary manufacturing. You see, we cannot get all the raw materials in one particular place. If we set up a chemical plant, we are still bringing in under high freight rates. If this is why it was done, if that is the only case, then we are still bringing in a lot of our raw materials. If you are making tires you have got to get the rubber, you have got to get sulphur, got to get nylon cord, things from all parts of Canada. If you are making furniture you need glass, you need various kinds of wood. You cannot just stay with white pine in the furniture factory. You have got to get things from all over the place, and they are sent to the factories where the aggregate of the prices are the least, and I cannot see any trend to go to centralization under this scheme.

COMMISSIONER PLATT: Mr. Hughes, are you not overlooking or not giving enough consideration to the economy of scale? That is, in most manufacturing processes now, this becomes a matter of importance, that unless you can manufacture more quantities of this particular article, you cannot get the cost down to your competitor. Therefore you have to have large immediate markets.

THE WITNESS: I think the trend, Mr. Platt, has been towards decentralization in the United States. We are getting the car factories on the West Coast, we are getting steel plants on the West Coast, for all kinds of reasons, and one of the reasons is because the population is growing out on the West Coast, because

our particular market is growing. Around Calgary, I believe, United States steel is becoming interested. They are thinking of building a steel plant out in the West. We may eventually get a car factory out in the West.

It is the market that is as important as the economy of scale, and we are certainly not getting centralization in the United States, we are getting decentralization, if anything. It has an awful lot to do with other things besides transportation, economies in management and so on through decentralization.

COMMISSIONER PLATT: This is true, Mr. Hughes, but do you envisage the time in the near future that there will be as many people in Western Canada as there are in the City of Los Angeles right now?

A. I cannot say that, but you certainly get factories in Denver, Colorado and Salt Lake City where the population will never be very big compared with Los Angeles, but you still get factories there, or you get them very often in the parts of the United States where the transportation prices are very often lower than in the other parts of the country.

You set up a factory in the south, even though it is a branch of a main factory in Detroit or Toledo or somewhere else. The trend is that way. Very often the reason is because it is nearer to the market, or you get economies of management because the firm was getting too big.

COMMISSIONER MANN: To some extent I suppose

the American experience is influenced by the existence of the value of service principle in the American rate structure.

A. Well, I think there is far more competition in the United States than there is here, and to the extent we have this competition, we have a great deal of trucking, many pipelines all over the place, railroads, barges, ocean shipping. I am quite sure that they are much more adapted to a cost of service type of rate-making than we are, so that transport prices in the States more nearly reflect the cost of transport than they do in Canada and we are not so diversified.

COMMISSIONER MANN: Mr. Hughes, if the cost characteristics of transporting skelp from Welland to Vancouver were the same as those of transporting the finished pipe, would there be a great incentive for having a pipe factory at Port Moody?

A. We have to assume, other things being equal, things at Port Moody, we can get terminal power, we can get good labour.

COMMISSIONER MANN: Other things being equal, we are trying to analyze the importance of transportation costs on the location, for example, of industry.

A. You have to hold everything equal and that is a very hard thing to do, and other things being equal, labour power and everything, there would be no advantage in having it at either Welland or out in Vancouver, Port Moody.

COMMISSIONER MANN: If there were existing

plants at Welland whereby incremental investment could take care of the increased capacity that are required to displace a plant at Port Moody, would there be much incentive for anyone to go to Port Moody?

A. Well, you have to make a great big leap of faith here in making everything equal, but we have almost an industry development. We have deep-sea water in Port Moody, for example. But if there was an existing plant in Welland, then there would not be any change to Port Moody. But, as I say, other things being equal, they are a bit unrealistic in this case because Port Moody is a good place to locate industry.

COMMISSIONER ANSCOMB: I suppose you would agree that the population factor, in other words the market of a mass of people, is very much more important to secondary industry than all the freights you might talk about for five years.

A. I am quite sure you are right there.

Q. Let me just tell you that years ago there used to be a tire factory did start in Coquitlam in British Columbia. It went broke twice because the population was not there to feed it.

A. Well, C.P.R. yards are there and they have something to do with it.

(Page 13583 follows.)

COMMISSIONER ANSCOMB: There is as much of a population in the State of California today as there is in the whole of Canada.

THE WITNESS: Yes. I think population has a great effect on secondary industry.

COMMISSIONER ANSCOMB: I am sorry for interrupting you, Mr. Cooper.

MR. COOPER: Q. Mr. Hughes, I refer you to Appendix B which is entitled "Rate making in Europe". I do not want you to go into great detail at all in answering this question, but can you indicate to the Commission briefly how your proposal compares with the railway rate structure now in effect in the United Kingdom?

A. Well, it is a long time since I was in the United Kingdom. I did have some preliminary discussions with the people who were setting up the case when I was in England. I used to meet them all pretty regularly, but this was a long time ago, and since then I have had no practical experience of what is going on there, but I do know that this 1953 Transport Act was passed, and that Act allows for maximum scales of charges only. The maximum scales were drawn up by the railways to cover the extreme ranges of cost so that no traffic would ever move at less than cost.

They brought this scheme up before the Transport Tribunal, and there was a hearing which lasted forty-four days, I understand, and the maximum scales were pared down quite a bit -- by about ten per

cent. The tribunal thought they were too high.

The law says that once this maximum scale has been agreed upon -- and it was agreed upon -- there shall be no minimum scale; the railways shall be absolutely free to have any rate that they want, and, moreover, that they have complete freedom. They do not have to publish any tariff. There are no tariffs. There is no classification. They have got complete freedom to do what they want. They can price the rate as high as it will go. Of course, they had to do away with undue discrimination and undue preference, but nobody seems to be worried about that.

This scheme has been working fairly well, obviously, because I keep seeing British articles about it, and not so long ago they sent around a questionnaire to the trade associations asking them if everything was going all right, and whether they are being affected by undue discrimination and undue preference; are they paying high freight rates, and so on. On the whole, everybody was very happy.

The railways can go in and give a competitive rate, and they do not have to give notice, and they do not have to publish it. They are on an equal footing with the traders.

So, it differs a great deal. There is not any real similarity between the British scheme and what we are wanting. The only similarity is that we want protection for the captive shipper, and we want this protection based on cost of service, so that

the captive shipper, with good cost characteristics, gets advantage of them. There is nothing like that in England. The maximum for the captive shipper can be anything that the Board wants.

We, of course, will have to keep on publishing our tariffs. I do not envisage not publishing tariffs or doing away with undue preference. We want a minimum scale also. There are other differences between our scheme and the British scheme.

Q. You have referred briefly in Appendix B also to the European situation,and here again I do not want any details in your answer, but it might be of interest to the Commission to have your comments on the situation in other countries on the continent of Europe. You refer in your Appendix to France, Sweden, Holland and other European countries. Can you give the Commission some information with respect to the situation on the continent of Europe?

A. The information I have on France-- I have never spoken to people in France on how they are doing. I know they have very fast trains, but that is all I do know from a practical point of view of France. I found one very good article in the British Transport Review which is published by the British Transport Commission. This is dated August, 1953. It describes the freight rates on French railways, and this is the only knowledge I have of them. They went over to a cost of service method of rate making, and they went over, it is said in the article, because of truck

competition and barge competition which forced the railways to take advantage of their low cost on certain lines. They went into a scheme -- I came across this after ours was printed, in fact. This was given to us by a member over the road, and this is what they do; they fix minimum scales to ensure that traffic is not conveyed at less than the direct costs, and they define those as being the out-of-pocket costs.

They have maximum scales for all the traffic. They have a loadability type of classification. The old classification no longer applies. They have a classification based on the weight that you can get into a car. To prevent any disruption, some of the old rates have been continued, and it is the new rates that are put into the new schedules.

I think that is about all I can say with respect to what happens in France. They have a scheme very similar to ours. As a matter of fact, they have four classifications of terminals. It seems -- and this is only a coincidence -- that they penalize poor loading in about the same way as ours would do.

THE CHAIRMAN: What is your information as to revenues?

THE WITNESS: I have not looked at the situation at all, Mr. Chairman. I have not looked at all at what is happening in France in regard to revenues. Did you say France?

THE CHAIRMAN: France and Britain.

THE WITNESS: In Britain they are not doing

very well.

MR. SINCLAIR: That is the understatement of the year.

THE CHAIRMAN: What is the reason for that?

THE WITNESS: I do not know about France, but I do know in England that they are not doing very well. I think I should give the reason in case Mr. Sinclair thinks it is the cost of service scheme that does it.

MR. SINCLAIR: I will talk about that later when I get my turn.

THE WITNESS: They are very over-capitalized in Britain because they had a lot of equity stock before the railways were nationalized, and instead of the equity being kept on and the government taking over the equity they gave everybody a bond at the same valuation of the equity stock, so they have this highly capitalized system entirely in bonds.

What has happened in England is that there is no overall investment policy in transportation, and then they have these new through-ways, one is now open up to Birmingham, and another is going up to Yorkshire and then up to the north. These exactly parallel the main railway lines so quite a lot of trucking is taking away traffic that otherwise would have been railway traffic.

At the same time, they are modernizing the railways. They are doing everything in parallel there, and there does not seem to be any overall investment

programme.

In order not to upset anybody they retained the old charges, even though they had gone over to the cost of service rate making. As the Commission can do what it likes, and it has gone to a cost of service rate making, they have said: "We will not change now any of the old charges that were in existence. We will not change that basis," so a lot of the old charges are still on the same basis and, of course, they cannot take advantage of the low main line costs.

In Britain they get as much featherbedding as anywhere else, and what has happened lately is that they have had a report on railway wages, and this report recommended roughly a ten per cent increase for all railway labour, but the report did not really say how railway labour could become more efficient.

MR. COOPER: Q. Could what?

A. Could become more efficient. They made a recommendation for a pay increase in England, but they did not say in the report, or did not recommend, that featherbedding should be discontinued, or any new working rules, or any of that kind of thing.

In Britain they have had a modernization programme going on since roughly 1953 and 1954. They are getting into dieselization, but they are working mixed train fleets now, which is not economic. Diesel fuel is quite expensive, but they are having to work both diesel and steam together which, as everybody

knows is not so economic.

They have not a great deal of captive traffic. They have certainly no lumber traffic in England on which to recover any losses, or anything like that. Everything is very competitive, and there are reasons why the British railways are not making money.

Now, with respect to France I have no information, and on Sweden I cannot say anything above what I have said in the brief. In Holland I know that they have a cost of service rate making scheme, but I do not think I am really qualified to say too much about it other than what is in here.

MR. COOPER: Thank you very much, Mr. Hughes. Those are all the questions that I have.

THE CHAIRMAN: We will take a recess now.

---Short recess.

CROSS-EXAMINATION BY MR. MAURO:

Q. Mr. Hughes, would you look at Part I of the submission to Table IV on page 9? That table is headed: "Inter-regional Transactions of Manufacturing Firms in the Lower Mainland Region of British Columbia who buy material or sell products in other regions, 1958." It seems very clear from that chart that while the prairie provinces are fairly good customers of British Columbia produce, British Columbia is not much of a market for prairie producers, and I wonder whether you know of any particular reason why that should be?

A. If you turn to page 23, Figure 2, in the same submission, Mr. Mauro, I think you will see that in the prairie provinces there is a very small population as compared with eastern Canada and down on the United States Pacific coast. I think that is the reason, whereas there is a concentration of population ---

Q. Apparently I did not make my question clear. I think your Table IV illustrates that British Columbia, for all of the smallness of the population of the prairie region, sells considerable produce to the prairie provinces, but that it is not a two-way trade; that, on the contrary, British Columbia receives the greater portion of its produce from eastern Canada than from the prairie provinces.

A. I do not see the relevance, because you probably have not got the things that we buy, and we sell to you the things that you want. You do not grow any fir, or things like that.

Q. I thought that might be your answer, Mr. Hughes, that we do not seem to have the produce that you want. I suggest to you, with respect, that in the Winnipeg metropolitan area every one of those items listed in Table IV -- food and beverages, rubber, leather and textiles, wood products, paper products, metal products, transportation equipment, electrical apparatus, non-metallic mineral products, chemical and allied products -- are produced, and that, in fact, the reason why the prairie provinces sell so little in the British Columbia market is due to the present freight rate

structure that permits manufacturers in Toronto and Montreal to ship into Vancouver at a price less than the Winnipeg manufacturer.

A. I would not really agree with you, Mr. Mauro. If you look at Figure 1 on the other side of the page there -- page 11 -- you will see that we sell quite a lot in the prairie provinces in spite of the high freight rates.

Q. I am suggesting to you that there is no problem with respect to Vancouver and British Columbia selling in the prairie region. What I was trying to assess was the reason why in Table IV, as you will note, the prairie provinces sell very little in the British Columbia market. I am satisfied that you can get into the prairie market.

MR. BRAZIER: With high freight rates.

THE WITNESS: We have to compete with the high freight rate into the prairie market. We sell much of our produce in the prairie market because we just do not get across the bridge.

MR. MAURO: Q. You do not get across the bridge?

A. Only 20.5 per cent of our produce gets across the bridge. We have to sell all our produce in the prairie market because, obviously, we are a long, long way away from central Canada.

Q. What reason do you attach to the fact that even though we restrict ourselves to the Manitoba manufacturer who does manufacture these products in a

fair quantity, I might say, but not up to the Montreal or Toronto level, you are supplied from eastern Canada. What reason do you attach to the fact that the prairie manufacturers do not seem to be selling equivalent quantities of produce in the British Columbia market?

A. I think you have to pin it down a little bit. It is no use saying rubber products, chemicals, or something like that. If the product is the same product -- there may be many long-standing relationships. I do not think you can say offhand it is due to the freight rate between Manitoba and Vancouver.

Q. Do you think the existing transcontinental rates and agreed charges between Montreal and Vancouver, and Toronto and Vancouver, make it in any easier for the Manitoba-Saskatchewan manufacturer to get into the Vancouver market?

A. I can see that if there were was a very low freight rate from Manitoba to vancouver then the Winnipeg manufacturer could sell in the Vancouver area, but there are all kinds of reasons for it. It may be moving in full trainloads, or something, from eastern Canada. It may move in small lots from Winnipeg. There may be firms which have had long-standing relationships. There may be all kinds of reasons other than the difference in the freight rate; I do not know.

Q. Just for the purpose of information, Mr. Hughes, on page 17 in Table VIII, what are those quantities? Are they pounds, cars or tons?

A. Tons.

Q. Now, your Table IX-A is entitled: "Average Freight Cost per ton and Average Length of Haul of all freight by Province of Destination." I wonder whether in the case of British Columbia there is included statutory grain destined to British Columbia? You have the average haul at 560.8 miles and the average revenue per ton of $10.9, and I wonder whether you have included statutory grain destined to British Columbia?

A. If you will just wait a moment I will check.

COMMISSIONER ANSCOMB: Which table is that, Mr. Mauro?

MR. MAURO: It is the one that was filed as a supplement. It is Table IX-A.

THE WITNESS: No, it does not include the statutory grain.

MR. MAURO: Q. I would assume that if you had included statutory grain destined to British Columbia then the average revenue per ton would have been reduced?

A. We have not the slightest doubt, but we do not take the grain in British Columbia. It comes straight through Alberta Wheat Pools and on to the ship.

(Page 13598 follows)

/1d

Q. Isn't that part of the freight destined for British Columbia, and isn't that part of the freight which increases your density on the lines? You have told us about the high density lines in British Columbia. Isn't part of that high density caused by the movement of grain?

A. Yes. But we don't include it in the cost per ton here, because when we get the grain we don't keep it, it goes straight through.

Q. Manitoba and Saskatchewan and Alberta let it go straight through, too.

We have drawn up some figures ourselves of revenue per ton-mile, Mr. Hughes, of the average revenue per ton-mile of freight destined to the four provinces, and these are as follows: the average revenue per ton-mile of all freight destined to Manitoba, 2.163 cents per ton-mile; Saskatchewan, 2.637 cents per ton-mile; Alberta, 2.904 cents per ton-mile, and British Columbia 1.107 cents per ton-mile.

A. Excluding statutory grain?

Q. No, including.

A. Yes. Is that a question, Mr. Mauro? Do you want me to comment?

Q. I would just like to complete your Table IX A and put in the other average revenue per ton-mile of freight destined. Similarly, Table XI on page ---

MR. BRAZIER: Might I ask, Mr. Mauro -- these figures you have just given are not similar to

the ones Mr. Cooper gave to the witness yesterday on a per ton-mile basis?

MR. MAURO: No.

MR. BRAZIER: These are quite independent figures.

MR. MAURO: Yes.

Q. On page 21, Table XI, under agreed charges, Mr.Hughes, average freight charge per ton by rate group, by originating province, 1957 -- we have worked out the revenue per ton-mile, under agreed charges: British Columbia, 2.06 cents per ton-mile; Manitoba, 3.50 cents per ton-mile, and the Canadian average is 2.64 cents per ton-mile. The next rate group, commodity competitive group: British Columbia, 1.34; Manitoba, 3.44; Canadian average, 1.93. Commodity non-competitive: British Columbia, 1.98; Manitoba, 1.82; Canadian average, 1.80.

On page 24, the paragraph which reads:

"Shipments from British Columbia, being bulky,
"heavy and travelling long distances, are
"ideally suited to rail and are in many cases
"tied to railways as there is no reasonably
"competitive form of transportation for
"these types of commodities."

Mr. Hughes, wouldn't you agree that your present favourable Trans-Continental rates and the rates brought about by competition from American railroads put the British Columbia producer in a comparably favourable position as compared to producers in Alberta,

[illegible]

Saskatchewan or Manitoba.

A. The sentence you have read out to me, Mr. Mauro --"...and are in many cases tied to railways as there is no reasonably competitive form of transportation..." -- we are saying here it is tied to the railways; it doesn't matter whether the railways are competitive. I would say in so much as we do have competition on the West Coast, not so much in the interior, and I would agree that we are in a favourable position compared to you in Manitoba or the Prairies.

Q. And the reason for instituting these low Trans-Continental rates was because of the potential or actual threat of Panama Canal competition which is hanging over the heads of Canadian railways, the fact that you do have an alternative, real or potential, of putting all these commodities, particularly the large and bulky commodities, by water.

A. If you are speaking about the bulk commodities moving by ship or the threat of it, I don't think there is very much moving by ship of bulk commodities. The threat is there, certainly, but there isn't much moving.

Q. Isn't the threat the reason for these rates? You think the threat is real, don't you?

A. If the rates went up any more, then we would get water competition.

Q. So to that extent you agree that if, in fact, British Columbia bulk movements have problems of being tied to rail, the situation of the producer in

Alberta, Saskatchewan and Manitoba is even worse than that.

A. It is no worse than our interior people, our apple people or interior lumber people. I am talking about Alberni and so on. Certainly they can't get a ship, or it is not economic to bring down rail movement into south British Columbia.

Q. Are not the interior movements affected and held down by the rates of American railroads to the east and other points in Canada?

A. There is an inter-relationship of all the freight rate structure throughout, yes.

Q. I notice in the next paragraph it states:

"Roads are difficult and costly to build
"through the province, and so trucks going to
"Eastern Canada travel via USA routes, paying
"licence fees in each state. As there are
"no reciprocal licence arrangements between
"the province and the several states or
"provinces, truck operation over long-hauls
"is very costly and impractical for the
"types of commodities which British Columbia
"has to offer."

I would assume that if roads are difficult to construct and maintain, then rail lines are similarly difficult and costly to maintain in British Columbia.

A. They were in the past, but when you take the economics of highway construction and operation and railway construction and operation, you get a

different situation. It may have been costly to build railway lines in British Columbia, but if you get the utilization it is the cost per unit that matters. We have to find the money to get the highways built.

Q. It is the nature of the terrain, it is the pure geography of the area which makes both railways and roads costly to construct and maintain in British Columbia.

A. You are talking about two different things here. The railway lines take the best route through the Rockies. The terrain is very bad for some of the communities, especially some of the coastal communities, where they would never think of building a railway line, because there is not enough traffic there. So when you are talking about the railway construction being high as against highways, you are not looking at parallel highways and parallel roads.

Q. Would you agree or accept the statement that the average track maintenance per mile in British Columbia was in the nature of $3,500 as opposed to a system average of $2,500.

A. I wouldn't until I could look at that.

Q. Now, on page 25, Column 1:

"Table VI shows the total rail transportation
"bill for British Columbia, with breakdown
"by type of rate and direction of haul. It
"is seen from Table VI A that the total
"domestic rail transportation bill for

"British Columbia in 1957 was $131 million,
"providing the railways with seven billion
"ton-miles. In other words, for domestic
"traffic only, British Columbia provided
"13 per cent of the freight revenues for the
"railways and 11 per cent of the freight ton-
"miles."

Is this including or excluding statutory grain destined for export?

A. In Table VI A, the two figures are given, of course. Looking at Table VI A, page 12, under the total freight column, and if you are reading along and you see "Total", then you get the part that includes statutory grain, and if you look underneath that you get excluding statutory grain. So we get both there. This is why we say we pay so much of the transportation bill; and, to be fair about it, if we take out the statutory grain, then maybe we don't pay so much. That is why we give the two figures.

Q. At Column 2 on page 25, the first complete paragraph, the sentence towards the end of the paragraph:

"The production of British Columbia, destined
"for overseas markets, being mainly forest
"products and minerals, is in close and
"direct competition with producers in other
"countries. British Columbia's producers
"have to accept the world price over which

"they have no control."

You would certainly agree that that is equally applicable to export grain.

A. I certainly would, yes.

Q. And that your producers have one definite advantage over the grain producer, that you are in close proximity to tide water as opposed to the grain producer.

A. Yes.

Q. As regards the bridge subsidy, Chapter 2 of Part 1, I wonder if you could advise the Commission whether the Province of British Columbia in 1949, before the Turgeon Commission, supported the principle of the bridge subsidy, or before the Parliamentary Committee?

MR. BRAZIER: It is a long time, Mr. Mauro, since I looked at it. I would like to doublecheck. My recollection is that we certainly did not before the Turgeon Commission.

THE CHAIRMAN: I do not think it arose before the Turgeon Commission.

MR. SINCLAIR: It was in Saskatchewan. It turned up, in a little different form. The seed was sown by Saskatchewan.

MR. BRAZIER: I think if we took a stand it would be before the Parliamentary Committee. Certainly we have changed our opinion; it is different today.

MR. MAURO: Q. Then following on that

chapter on page 35, Mr. Hughes, under "Effect of the Bridge Subsidy", this appears:

"That is, in fact what has happened, but it "is obviously true that British Columbia ships "very little grain eastwards and so gets no "relief from Crowsnest rates. But this is "not all. British Columbia has very little "qualifying traffic passing over the bridge "in an easterly or westerly direction, hence "the benefits, if any, are extremely small "as compared with the benefits to more "easterly provinces who in any case get the "full relief from export grain rates."

Now, firstly, to the fact that British Columbia ships very little grain eastward, similarly, Alberta ships very little grain eastward. That is true.

A. That is true.

Q. And, in fact, British Columbia receives a considerable benefit from the fact that Crow rates were extended west. You heard Mr. Stenason say that the movement of this grain to Vancouver -- there are cars available for import traffic coming into Vancouver.

A. Yes, that is true, of course.

Q. And you wouldn't be agreeable, I imagine, to having the Crow rate removed from westbound shipments of grain, put an arbitrary on the movement of grain through the mountains?

A. No, we have never said we wanted the statutory rate altered, either east or west.

Q. You are satisfied that British Columbia does receive a benefit, when initially it was only ---

A. If we hadn't had the same rate, we would have had no traffic, or very little traffic.

Q. Do you think that traffic benefits you?

A. It benefits Alberta and the Wheat Pool. We get the Port working, but there is a very real benefit to Alberta, because they wouldn't be able to ship it out of Alberta.

Q. What I am trying to get from you is whether or not British Columbia believes it receives any benefit from the movement of the grain at statutory rates.

A. Yes, we certainly get benefit from that.

Q. Then on page 36, Column 1, you refer to Table XVIII.

"Table XVIII indicates that out of total
"domestic carload traffic, 20.5% travelled
"over the bridge, 79.5% of the traffic moving
"by rail originating in British Columbia is
"therefore not eligible in any event for the
"bridge subsidy."

Now, you would agree with me, Mr. Hughes, that any traffic from British Columbia falling within the non-competitive classification and moving over the bridge does, in fact, receive the benefit of the bridge subsidy.

A. Yes.

Q. And that the considerable traffic -- there is a considerable movement of traffic from Eastern Canada moving over the bridge not subject to the bridge subsidy simply because the rates are competitive or agreed charges.

A. Yes. I think the figures are given here in Table XIX. Yes, there is a good amount of traffic.

Q. A very considerable amount of traffic moving to British Columbia from Ontario and Quebec, and the only reason you are not subject to or receive any benefits under the bridge subsidy is because that traffic is moving at agreed charges or competitive rates.

A. Well, I know it is considerable. We get 181 cars from Ontario, and I am looking here at Table XIX -- we get 189 cars from Ontario into British Columbia, both eligible and ineligible, out of all the traffic that is moving to Ontario from the four Western Provinces.

Q. 169 is the figure.

(Page 13613 follows.)

A. Ontario destination going to British Columbia, these are the columns, Column 2 and 4. 181 acres, eligible and ineligible, so we do get ---

MR. FRAWLEY: I don't see the figure 181 anywhere.

THE WITNESS: Adding up 21 acres and 160 acres. So this pins down to what you are saying that we do get benefits.

MR. MAURO: Yes.

A. Yes, we get some benefits.

Q. From that table we referred to anyway, you find very little in the Prairie Provinces, so here you put an example being outside of the Prairie Provinces and since the only provinces I can think of are the provinces which you might refer to as "far east" Ontario and Quebec, this is moving in considerable tonnage, subject to the bridge subsidy. This is because it is moving at competitive rates and agreed charges.

A. Yes, the bridge subsidy does benefit.

Q. Alberta the near east, Manitoba and Saskatchewan the middle east, and the rest the far east, and the simple fact that 79.5 per cent of your traffic is not subject to the bridge subsidy is that 79.5 per cent of your traffic does not move over the bridge.

A. Getting into the three western Prairie Provinces, that is right, yes.

Q. The whole purpose behind ---

A. 79.5 does move out. This is for the four western provinces.

Q. For the four western provinces, and it does not come anywhere near the bridge, and that is why it does not receive the bridge subsidy which was instituted to correct it.

A. That is our whole point. We are getting nearly 80 per cent of our traffic in the Prairie Provinces and we are competing against the other traffic coming from the far east (if you like to call it) Toronto and Montreal. We are getting it all into the Prairie Provinces. They get the subsidy for the bridge where we do not.

Q. The consumers are receiving the benefit of the bridge subsidy, as the consumer in Saskatchewan and Alberta is receiving the benefit of it.

A. Consumers are to some extent certainly but our producers are not.

Q. The consumer to some extent? The consumer is getting the benefit out of the bridge subsidy to the fullest extent set out in the bridge subsidy.

Every pound of goods getting into British Columbia over the bridge at a non-competitive rate receives the benefit of the bridge subsidy; is that correct?

A. Yes.

Q. At page 37, there is a sentence there, Mr. Hughes:

"The position is then that British Columbia
"receives little benefit from the shipping
"of eastbound traffic over the bridge. The
"westbound traffic does not alleviate the
"situation because it enters B.C.'s market
"at subsidized rates, thus being able to
"undercut B.C. distributors. Most which traffic
"does pass onto British Columbia in a westerly
"direction does so at full unsubsidized rates."
Do you mean unsubsidized competitive rates, what do you mean by "unsubsidized"?

A. Just a second.

Q. It is at the bottom of page 36?

A. Yes, I have the reference. I am just reading it if you don't mind. That is what I mean, yes.

Q. You mean we could interchange "unsubsidized" and put in the words "in a westerly direction does so at full competitive rates"?

A. Competitive rates, if you want to put it that way.

Q. That would be it, because if it were not competitive, it would not be subsidized, it would not receive the benefit of the bridge subsidy?

A. That is right, yes.

Q. In the next short paragraph,
"Not only British Columbia loses by reason
"of the bridge subsidy but the railway dis-
"sipates its revenue by voluntary reductions
"not required by law, thus further burdening

"the shippers who have to pay full rate." I wondered whether you would group in these voluntary reductions not required by law, re-charges to the West Coast?

A. No, I would not. I am talking about, I am grouping in here -- it all refers to the paragraph that goes along after it.

Q. Well, I just thought that you are referring to the bridge subsidy, but you are mentioning about dissipation of rail revenues.

A. Yes, I am talking about rail-lake-rail rates.

Q. I am aware that Mr. Cooper discussed this with you yesterday, and I know what you are referring to. I am just wondering whether or not you would group in there as voluntary reductions not required by law, such rates as re-charges to the West Coast.

A. I cannot see that agreed charges dissipates the rail revenues. To dissipate revenues you have to dissipate your net revenues, the difference between the costs and the gross revenues which you receive.

When the railway puts in an agreed charge, I cannot see it doing it conceivably to decrease its net revenues. It must be wanting to increase them. It does not dissipate revenues. It is probably doing it the other way around.

Q. Let us think about that for a moment.

Certainly in instituting an agreed charge, the railway does not lower costs. The costs remain the same as they were before.

A. I cannot see that. It is getting regular traffic on a contract rate. I do not see why the costs should remain the same.

Q. Actual cost in absolute dollars of performing the service remains the same. What you are suggesting, that there may be a per unit reduction brought about by increased volume.

A. I don't agree with you that the total cost remains or your per unit cost remains the same on an agreed charge. This is what I suspect. I cannot see that, because you have your contract there, you know what traffic you are going to get and everything else.

Q. Do you suggest the full and agreed charges, the example I took, would go down with the increase in traffic?

A. I know that some agreed charges, if they did not have the agreed charge they would not get the traffic.

Q. What we were discussing is the dissipation of revenues by voluntary reductions not required by law. What I suggest to you is that the cost of providing the service in absolute dollars the day that the agreed charge to the West Coast was instituted, were the same as they were the day before, the absolute costs of moving the traffic; and that what the railways

are doing under the agreed charges, the principle of it, they hope to increase their volume and that while reducing their per unit charge, they will have a resulting increase in net revenue, is that right?

A. I would say they have an increase in net revenue because of a different -- I do not look at it as dissipation of revenue, I look at it as attracting revenue.

Q. Page 49, Mr. Hughes, footnote No. 5. I wonder if you could give me the source of that.

A. This is the last footnote?

Q. Yes, the last footnote,

"Of greater importance in the export freight "of Canada and giving similar benefits to "Canada is lumber. The trade has grown to "such eminence though the producers have "never asked, nor have received, any similar "statutory rates. It may be worth con- "templating what a position lumber could have "attained in overseas markets given the same "rate advantages as grain".

Can you give me the source of that?

A. This is what I say, this is my opinion.

Q. That is your opinion?

A. This is, footnote 5, yes. This is what I say it is worth contemplating.

Q. Can you tell us what is the distance that lumber moves to export positions in British Columbia?

A. Fairly short. I do not know the distance. We export quite a lot of lumber from New York, the Eastern Seaboard, Chicago and Midwest. We send quite a lot of lumber over there. The average length of haul of this I do not know, but I should think it is about 17, 18, 19 hundred miles.

Q. What is the average length of haul to move your lumber to points of export, to tide water, Mr. Hughes, Kingsgate, for example?

A. We are looking at the export of lumber here, export to the United States, which is an export of lumber, and to Manitoba, is it 1,500 miles?

Q. Crow's Nest rates are to move grain to export position, to Vancouver, Churchill or Fort William. Now, each of those cases is to move into position where they may be loaded onto ships for export to overseas markets. Now, would you give me the comparable distance for movement of lumber to points where it can be loaded onto ships for export.

A. This is my opinion down here and this is what I wrote. What I am referring to here when I talk about export, I am looking at our big markets in the United States, of course. That is what I had in mind when I wrote that -- for which we do not, we never asked for any statutory assistance. We do not want any.

If you want the mileage to the port or something like that, it is about 100 miles, I suppose, in some instances.

Q. Your last line of your own footnote says:

"It may be worth contemplating what a
"position lumber could have attained in
"overseas markets given the same rate ad-
"vantages as grain."

It is those overseas markets I am interested in. Can you give me the mileage to export position for lumber moving to overseas markets, not New York, but overseas markets?

A. It is a very small radius around Vancouver because the traffic otherwise goes by rail.

Q. Would it be 40 or 50 miles?

A. 100 miles, 120.

Q. Do you think that is comparable to the distance grain has to move?

A. No, as I say, when I wrote this I had in mind our huge market in the United States.

Q. That is what you refer to as overseas markets?

A. Yes.

Q. That is, overseas markets to the United States.

A. Well, I have used just as a general term outside Canada anywhere, and it is export markets. "Export markets" and "overseas markets" seem to be the same thing.

Q. So the rest of Canada means the east and the United States is overseas.

COMMISSIONER GOBEIL: What would be your

percentage of lumber going on the eastern coast of United States, would you know?

A. I do not know. I really cannot tell you. We do not have any waybill studies on this. We would have to ask the individual producers.

MR. BRAZIER: I was inquiring whether or not there was a copy of this publication available. There is a great deal of statistical information given in the annual report of the B.C. Lumber Manufacturers Association as to where the shipments go.

THE WITNESS: Yes, I cannot tell you how many carloads but there are a lot of figures in lumber here.

MR. MAURO: Q. Fine.

A. We can't say for the eastern United States.

Q. But the point, Mr.Hughes, is that your footnote, when you refer to "overseas markets", you mean United States.

A. Yes.

Q. That clarifies that footnote. Now, at page 50, between the tables and the foot of the page, there is this statement:

"Carryover of grain, stimulated by such
"measures as statutory grain rates, has
"increased in the last ten years."

I wonder if you could explain to us how the statutory grain rates have stimulated the carryover of grain.

A. Well, if the farmer gets a low rate for

carrying his grain, obviously he is going to put a lot more grain than if there was a full freight rate, if he gets a subsidy one way, whether by the Government or whether by other shippers. If he is paying a lower rate than normal rate, then he is going to expand his production more than he would have otherwise done. Otherwise, he may have gone into the production of something else.

Q. Is not the carryover determined by whether or not there is a world market for selling wheat?

A. Market is one thing, but the supply is the other. We cannot take one without the other.

Q. Do you think the production of wheat in the last ten years has increased?

A. The acreage may have gone down, but I am sure the yield per acre has gone up.

Q. Then at page 51, you state that the Government should continue to stimulate the grain industry. According to my reasoning, this would only result in greater carryovers. This goes over to page 52:

"There is little doubt that stimulation to
"the industry should still be given in the
"interests of Canada."

Would not stimulation simply result in greater carryover?

A. Yes, I think that we had great advantages in producing grain. Agriculture as a whole is one of the things in our national lives, and I

certainly that the Government should stimulate its agricultural pursuits in Canada. It is one of their natural advantages.

Q. Then if there is this large carryover that troubles you that we cannot sell the product with the world market glutted with grain and grain products, and the Crow's Nest has contributed to the glutting of the world market with grain and grain products, still you contend that the Dominion Government should stimulate the production to add to the glutted world market?

A. I think the grain growing industry here is of importance, and the government should keep on stimulating it in the demand way as well, see if they can find markets, have a look around and see if we can get rid of some of this surplus, keep on doing this.

We certainly do not want no stimulation, I think. We want to keep it on, to diversify if possible or get into other crops. Grain covers a lot of things.

Q. Page 52:

"There is little doubt that out-of-pocket
"losses on grain have led to rate increases
"on other traffic being greater than they
"would otherwise have been. In other
"words, any required increase in rates would
"be borne by a larger base if export grain
"were included."

I suggest, Mr. Hughes, this would be equally applicable

to any rates that did not take the full increase regardless of the reason.

A. No, I do not agree with that. This is why I do not agree with it. Any traffic carried on out-of-pocket loss is burdening other traffic. Because you do not increase the compensatory rate, it does not mean to say that other traffic is taking no burden, because, as I say, it is the net revenue base that is important to us. If you increase the rate, you might lose all the traffic or a lot of the traffic and make the burden worse.

Q. We are talking here about "have led to rate increases on other traffic being greater than they would otherwise have been" and I want to refer to the last 17 per cent case and the railways' requirement of $30 million and their estimated method of recovering that. I suggest to you, Mr. Hughes, that for every agreed charge to British Columbia that was unable to sustain the increase of 17 per cent, that some other traffic had to absorb that increase.

A. Well, no, you see rate is not the important thing. If the rate goes up, as I say, you may lose some traffic and dissipate your net revenues. It may be better to bring your rate down because your traffic may go up; your per unit revenue may decrease but your total revenue goes up.

Q. Mr. Hughes, in the Canadian situation where we have the requirements formula and the railways put in a general application and ask for X dollars, I

suggest to you that the statement appearing at page 52 of your Part 1, that rate increases on other traffic are greater than they would otherwise have been, due to the fact that certain -- in other words Crow -- traffic did not obtain the increase, applies to any traffic that does not in fact sustain the full increase as required by the railway.

A. No, for the reason I have just given you, I would agree with you if you are talking about traffic carried at out-of-pocket costs, then I would agree with you, but not otherwise. The railways have to carry this competitive traffic and they may actually increase their net revenue or they may maintain the net revenue.

Q. That is the point. If they only maintain the revenue from the agreed charges to British Columbia but they need an additional $30 million, they are not going to receive the proportion that the agreed charges to British Columbia should have contributed to the net increase.

(Page 13628 follows.)

A. If they put the rates up on the competitive traffic they would lose it, and they would not have any revenue. If they put the rates down they might get more traffic and increase the net revenue of the railways.

Q. I am completely in accord with you on the principle that it is better to carry a lot of traffic at a little profit than a small amount of traffic at a big profit, but what I am saying here is that the statement you make that out-of-pocket losses on grain have led to rate increases on other traffic being greater than would otherwise have been the case is just as applicable to any traffic that was unable to take the increase, because the railways had to turn to other traffic then, namely, the captive traffic?

A. I do not agree with you at all.

Q. Therefore, under your philosophy, if the grain rates were compensatory; if the grain rates returned their out-of-pocket costs, then it is all right if they do not receive any further increase? They will place no burden in the future if they received no further increases?

A. Well, I say here:

"There is little doubt that out-of-pocket losses on grain have led to rate increases on other traffic being greater than they would otherwise have been."

You say: "Okay; if grain rates are now compensatory -- well, at some time or another we will certainly get a

rate increase, but the rate increases would not be greater than they would be if the out-of-pocketlosses are still incurred.

Q. Now, Mr. Hughes, in the last general rate increase the railways asked for $30,000,000 -- that was in the case of one of the roads -- to compensate for a wage award, and nothing but a wage award. I assume that that increase applied to carrying traffic under agreed charges just as much as it applied to the carrying of captive traffic. You would agree with that, would you not?

A. I would agree with that, yes.

Q. All right. The day after they received the 70 per cent increase the railways tried to increase the agreed charges by 17 per cent to compensate them for the increased wage costs of moving the traffic under the agreed charges, and they were unable to increase the agreed charges 17 per cent because if they increased them by 17 per cent they would lose the traffic. Are you suggesting to this Commission that if that situation arose there would not be an increased burden placed on the captive traffic due to the fact that the agreed charge traffic could not sustain the 17 per cent increase?

A. If they had been able to put the 17 per cent increase on the agreed charges, and if they would have got the same amount of traffic as before -- if those two things had happened -- then we would not have had as great a rate increase as we did have; that is, if there was no loss of traffic.

Q. If they could not place the 17 per cent increase on the agreed charges I am suggesting to you that the extent that they cannot absorb the increased wage costs of carrying the agreed charges then that is a burden that is placed on the captive traffic?

A. Yes, I agree with that.

Q. Do you have any idea, Mr. Hughes, as to the number of rates from British Columbia that have gone up 157 per cent since 1946?

A. Well, if I can take notice of that and let you know, I will do so.

MR. MAURO: Yes. That completes Part I, Mr. Chairman. Perhaps you would like to recess here.

THE CHAIRMAN: Yes.

---Short recess.

MR. MAURO: Q. Mr. Hughes, may I turn to Part II of your submission, and to Chapter 6, which is the opening chapter? Paragraph 2 in column 1 reads as follows:

> "There are three basic methods of rate making which, though not mutually exclusive, have distinctive characteristics. The methods are setting rates according to:
> (a) value of commodity;
> (b) value of service;
> (c) what the traffic will bear."

I would like to read to you the series of principles

appearing in the Freight Traffic Red Book for 1955, and ask you whether you, as a student of this subject, would agree that these are the factors that are taken into consideration. I am reading from page 30:

> "In making a rate the principal factors taken into consideration are the following:
>
> (a) cost of the service to the carrier.
>
> (b) value of the service to the shipper.
>
> (c) value of the article.
>
> (d) nature of the article -- whether crude or finished, liquid or dry, etc.
>
> (e) risk in handling the article.
>
> (f) distance of haul (mileage scales).
>
> (g) bulk (size) and weight of the article. (Density).
>
> (h) whether special facilities or extra services are required.
>
> (i) expense at terminals.
>
> (j) volume of traffic and periods of movement.
>
> (k) method of packing and protecting the article.
>
> (l) rates on similar articles moving under similar circumstances and conditions.
>
> (m) rates of competing carriers.
>
> (n) competition between producing centres or markets.
>
> (o) whether or not the rate will be conducive to an increase in movement of the article.
>
> (p) prospects of cars being returned loaded or empty.

(q) rates account Fourth Section of the Interstate Commerce Act."

That is the short-haul clause.

"(r) loading (per car)."

I would suggest that perhaps those are the principles or methods by which rates are set, and you will note in that that the value of the commodity is ranked No. 3, but I suggest that that is just the listing of them. However, those are more or less the real considerations that go into the establishment of a rate?

A. That go into establishing which particular rates? Do you mean what I call the value of commodity rate, or what the traffic will bear rate? Not all of them go into every rate.

Q. I say they are the considerations. They may not, in fact, appear in all rates, but in varying degrees those are the considerations that a rate making authority or a traffic man of one of the carriers would consider in determining rates, including cost of service?

A. Yes, they can include one of those, or them all, certainly.

Q. I am trying to point out that your list is incomplete in stating what is considered in determining rates.

A. I do not think so. I think my list here is complete with the exception of (d) which should have been cost of service, but you can fit any one of

these into these three and cost of service. It classifies them into four groups.

Q. You told my learned friend Mr. Cooper yesterday that you felt that the value of commodity was the primary consideration, and that is one of the reasons why it was listed first in the joint submission of the railways. I wonder if you know whether the price of shipping a Cadillac -- that is, the price per 100 pounds of Cadillac is greater than the cost of shipping 100 pounds of Ford?

A. I would think that the insurance cost is higher. It is a more valuable article, and there may be a higher cost included there. There may be other factors that just take into account the value of the article that has nothing to do with the cost.

Q. I am suggesting to you that in the case in point there would be no difference in the rate of shipping 100 pounds of Cadillac as against 100 pounds of Ford, even though the 100 pounds of Cadillac is worth more than the 100 pounds of Ford?

A. That is one little thing, but if you want me to go through the classification we will have a look at things which you can pick out, but this is what Mr. Locklin says about the value of commodity being in the classification rate, and, of course, a lot of people say this as well:

"The more important reason for the differences in rates on cheap and on valuable articles is found in the greater

ability of the valuable articles to
stand a high rate. In other words,
there seems to be a relation between
the value of the commodity and the
value of the service of transporting
it."

That is where that gets in.

Q. Do you feel, Mr. Hughes, that the value of the commodity is, in fact, of primary concern in establishing a rate?

A. Yes, I do. I am not looking at the Classification, obviously, but I think the rating on unfinished coffins is 55, and the rating on finished coffins is 100. I am not sure of those figures, but there is a relationship like that that may well have to do with the value of the article. One has brass fittings on and the other is just unfinished.

Q. That is under (d) of that series -- the nature of the article, whether crude or finished, liquid or dry-- and is not under the value of the article. There are various rates, if you will look them up, for such things as new and used clothing, and you will find that the rates are the same, generally, for secondhand and new articles. You will find that the rates on the same article, secondhand or new, are the same, and I am suggesting that actual value of service and cost of service coupled with those other factors such as bulk and handling characteristics, special equipment, return empty movement, etc., are

the considerations in establishing a rate?

A. Yes, but in the classification the point I am making is that the value of the commodity is an important consideration, and Mr. Jackman says that in the footnote -- and I gave you the reference; he says that, and Mr. Creery says it, too, that the value of the commodity is an important consideration in the class and class related rates.

Q. You told Mr. Cooper yesterday it was the most important thing?

A. Yes.

Q. You discussed with my learned friend Mr. Cooper yesterday some of these problems in paragraph 1, and the one that stuck out in my mind, Mr. Hughes, was the fact that I think you told the Commission that the railways should be permitted to assert their cost advantages. I think that is a fair interpretation of what you said. Can you tell us what hindrance is presently placed on the railways today in instituting rates to maintain traffic and to reflect their cost advantages?

A. I think when they have equalization they have to give the same rates in whatever part of the country it is -- the same class rates and the same commodity rates -- but they are not allowed to put in rates lower than are necessary to meet the competition.

Q. Lower than necessary?

A Yes, to meet the competition. Those are

the two instances.

Q. Are you suggesting ---

A. The one and one-third rule is another one where they cannot really take advantage of low costs in Vancouver. They may have to give exactly the same rate into Alberta.

Q. Mr. Hughes, would you tell me how much traffic is moving under the class rates? Do you know how much traffic is moving under the class rates?

A. In Canada I would say it is about eight per cent by value.

Q. I think Mr. Roberts told us it was about five per cent.

A. Yes, it may be about five per cent.

Q. What about the agreed charges? Is there any limitation or restriction placed on the railways in Canada today to make a contract price bringing into reflection their cost advantages?

A. No restriction, no.

Q. Does the one and one-third rule stop the railways from instituting any number of agreed charges to the west coast that the one and one-third rule would not apply to?

A. No, of course not.

Q. I suggest in a number of books that you have read, Mr. Hughes, particularly American texts, and certainly the ones I have read, when they talk about allowing the railways more liberty to assert their cost advantages they are talking about a situation which does

not exist in the United States but which exists in Canada today, namely, the availability of contract prices and agreed charges?

A. They are coming around to having contract rates in the United States now, yes.

Q. I suggest in Canada today there are no real limitations placed upon the Canadian railways that are a hindrance to their asserting their cost advantages.

A. I would say there are. There are rates that cannot go lower than necessary to meet the competition. The railways have to take notice of the competitive costs, and not their own costs. They are asserting their competitors' costs.

Q. Are you suggesting that the railways should, in fact, be permitted to make rates that are even lower than necessary to meet the competition?

A. Yes, that is in the brief here.

Q. I have just been informed that in the incentive rates case the railways were permitted to go 50 per cent below the truck rate, and the Board felt that this was permissible?

A. Yes, because this was a sharing of the traffic. They thought that this was no lower than necessary to meet the competition, taking into account all the service characteristics of the trucks.

Q. But 50 per cent below the price charged by the competition?

A. But price is only one factor. Service is another factor. If you have no differential

between rail and ships on the lakes, then the lakers would not get any traffic. There has to be a differential to account for service differences if each form of transport is to get some traffic.

Q. Certainly every non-competitive rate is below the rate of the competition, is it not, Mr. Hughes, otherwise the competition would be taking it away? Every non-competitive rate is below the level necessary to meet the competition, or otherwise the competition would be there? That is what makes it a non-competitive rate?

A. Certainly it is, yes.

Q. I am still trying to find those areas where the railways are hindered from asserting their cost advantages?

A. I have told you that in having to go lower than necessary they are certainly hindered from not asserting their cost disadvantages in equalization. There is another side to the coin as well.

Q. You think there should be more freedom to have non-competitive rates, or, in other words, there should be more captive traffic? This would be giving them full opportunity of utilizing their cost advantages by putting in a rate so low that the rates became non-competitive?

A. Putting it broadly, I say that rates should bear a relation to costs. They should be cost-oriented. You seem to be interpreting it in a way I cannot understand there.

Q. I am suggesting that in two very large classifications, agreed charges and non-competitive traffic, which take a fair proportion of the present traffic in existence -- that in the case of agreed charges they can enter into any rate they want which, I trust, is compensatory, and all those alternatives -- the one and one-third rule and equalization -- do not apply to those rates, and that in the field of non-competitive traffic those rates must now be at a level which not only takes into consideration the cost advantages of the railways but makes it impossible for other competitive media to cut in?

A. Well, on non-competitive traffic those rates are not cost related; they are there because the railway has not any competition, and it can put the rates up to where it wants, but they are not related to the cost advantages of the railway. With respect to bulk commodities which are good loading I am sure the rates are high.

Q. But you said price was only one consideration; that you had to take in all considerations, such as the load, the handling of it and all these other aspects. They are all taken into consideration in determining this non-competitive rate. Your position is that at present the railways are actually hindered, and as a result there is a real problem in respect to the railways in Canada today due to the fact that they are hindered in not being able to lower their rates below the level necessary to meet competition?

A. I would not like to have this rate freedom subject to their not going below out-of-pocket costs, and having captive traffic not going above ---

THE CHAIRMAN: In other words, you want greater freedom?

COMMISSIONER MANN: You would take out Section 334 altogether?

THE WITNESS: Except for subsection (2), subparagraph (c).

COMMISSIONER MANN: Do you feel the railways might feel inhibited in their competitive rate making by the non-mandatory requirement to show the Board that competition actually exists, and to give the name of the carrier, the route and the rate of the carrier? Do you think that is a restriction on the railways' freedom to make rates?

THE WITNESS: The real restriction there is that the rates shall not go lower than necessary to meet the competition, and in order to establish what competition there is then the Board wants to know these other things as well, but the real restriction in that is that the rates shall not go lower than necessary to meet the competition.

COMMISSIONER MANN: You have heard Mr. Mauro refer to the western incentive case, and the percentage there was given as 50. I recollect that some of these western incentive rates were up to 72 per cent below the truck rates, and that that was found reasonable by the Board.

THE WITNESS: Yes, and the trucks are still moving the traffic because the rates were not put lower than necessary to meet the competition. The trucks are still competing, and they are sharing the traffic.

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MR. MAURO: At page 11, paragraph 39, the paragraph reads as follows:

"The pricing of transport services on a cost
"basis actually ensures co-ordination of
"transportation. By co-ordination is meant
"the harmonizing of transportation operations
"so that each agency does the work for which
"it is best suited. The shipper will
"automatically bring about co-ordination by
"choosing the lowest form of transportation in
"his own self-interest."

Now, I have interpreted this paragraph, Mr. Hughes, as meaning that you want to see a system where the most efficient and economical carriage of goods and people result.

A. Yes.

Q. And that the various cost advantages of the rail, road, water, airline and pipeline are brought to bear on our transportation in Canada.

A. You have put it very well, Mr. Mauro.

Q. Section 3 of the Transport Act, as you know, reads:

"It is the duty of the Board to perform
"the functions vested in the Board by this
"Act and by the Railway Act with the object
"of co-ordinating and harmonizing the
"operations of all carriers engaged in
"transport by railways and ships and the
"Board shall give to this Act and to the

"Railway Act such fair interpretation as
"will best attain the object aforesaid."

My particular interest was that you used the word "harmonizing", and "harmonizing" appears in the Transport Act. You know that the Winnipeg Chamber of Commerce had a hearing on the water and rail rates not too long ago, and the Board, in upholding the differential in setting water rates -- it is at a fixed level below rail rates, and the Board stated:

"The increases permitted in the rates via
"the differential routes between Eastern and
"Western Canada were properly made under the
"powers of the Board, and, except as stated
"in Finding No. 2, have not resulted in
"unreasonableness in the general level of the
"said differential rates . . . "

Now, reading from page 505 of the Judgment:

"One of the duties of the Board is stated
"in section 3 of the Transport Act, as follows:
"'It is the duty of the Board to perform
"the functions vested in the Board by this
"Act and by the Railway Act with the object
"of co-ordinating and harmonizing the opera-
"tions of all carriers . . . '"

Now, I take from your paragraph 39 and your paragraph 92, where you state:

"Cost-oriented rate-making is possible if
"rates are to have more regard for the costs
"of a competitor rather than of the railway

"itself."

I take it from this that you want to see a rate structure in Canada that reflects the actual costs of the carriers involved and not tied to the cost characteristics and cost factors of competing carriers.

A. Yes.

Q. And when you use the word "harmonizing" at page 39, you mean it in that sense rather than the sense that the Board has put on it.

A. Yes. When I wrote that I didn't know that the word was in the Act, "harmonizing", I didn't realize that.

Q. At page 15 of paragraph 51, Mr. Hughes, you said:

"Minimum rates in any cost-oriented pricing
"system should be related to out-of-pocket
"costs. It is these costs that are incurred
"if the output takes place. If they were not
"recovered in full, therefore, out-of-pocket
"losses would occur, and the railway would
"be better off by not carrying the traffic."

Then you quote Professor Merril Roberts of the University of Pittsburgh, particularly the paragraph which reads:

"Fully distributed costs are a false pricing
"standard because of adverse effects on revenue
"generation."

I assume you are quoting Dr. Merril Roberts with approval that fully distributed costs are, in

fact, a false pricing standard.

A. Yes. Dr. Merril Roberts has in mind that as a minimum cost base, and I do this with approval, I fully agree with him.

Q. He says:

"It is quite meaningless to establish as a "norm for rates a sum composed of out-of-pocket "cost plus an arbitrary pro rata share of "the overhead . . . . In many circumstances, "a rate lower than the fully distributed "costs yields a greater total contribution "to profit than one which equates with this "statistical allocation."

I think he is stating that the whole concept of fully-distributed costs as a rate medium is fallacious, that you have to consider each and every movement on its own merits, because a volume movement at a rate less than fully distributed costs will make a greater contribution to revenue than even at or twice fully distributed costs.

A. Yes. The norm for rate-making should be the out-of-pocket costs.

Q. At page 22, Mr. Hughes, paragraph 81, I read:

"The method is infinitely superior, on all "counts, to the other two. It does not "unduly burden any class of traffic more "than that traffic can bear, providing that "the traffic is not captive to the railways."

You are, of course, in agreement that one of the primary concerns of this Commission under its terms of reference should be the consideration of protection to the captive traffic; that is one of the real issues.

A. Yes, that is one of the reasons this Commission was brought in, because there was an ever-greater burden getting onto the normal traffic, and I am sure that is one of the concerns of the Commission.

Q. Now, at page 24, Mr. Hughes. As I understand your method now, this new proposal for rate-making, there will be a minimum rate for all traffic, which minimum rate will reflect the long-run out-of-pocket costs; is that correct?

A. That is correct.

Q. There will be a maximum rate on captive traffic, which maximum rate will be not greater than the fully distributed cost.

A. That is right, yes.

Q. And then to all traffic non-captive, the sky is the limit.

A. The captive was the limit, I would say, not the sky is the limit.

Q. What the traffic will bear.

A. Yes, that is right.

Q. Whatever they can get, as long as it is above long-run cost.

A. Yes.

Q. Let's try to get down to a particular

illustration. In the last general increase case which was for $30 million or 19 per cent increase, they were eventually awarded 17 per cent, and under your system they could go out and establish rates on the captive market that returned no more than fully distributed costs.

A. Yes.

Q. What if they went to the non-captive traffic and attempted to regain the balance of the $30 million and were unable to obtain it, how would they make up the deficiency?

COMMISSIONER ANSCOMB: Would you repeat that question, Mr. Mauro?

MR. MAURO: Yes. In the last general application, Commissioner Anscomb, the C.P.R. asked for $30 million revenue to make up their wage award. Under the British Columbia proposal, they could establish rates, if they were granted this application, on the captive traffic which would reflect not more than fully distributed costs, and let's assume that returned to them $20 million, they could then go out to the non-captive traffic and try to get as much as the traffic could bear, and assume that returned another $5 million, my question was: how could they make up the deficiency of the $5 million?

THE WITNESS: Now, under the present scheme, we have equalization, we have out-of-pocket loss, grain, some l.c.l. traffic At. and East grain rates, probably export grain rates. If all these deficits were

compensatory out-of-pocket, then we might get $200 million without any need for a rate increase at all.

Q. Assuming that the dark day comes again when all these deficits have been removed or reduced to the furthest point possible and still the railways come back to the Board for an increase -- and I assume we have to presume that there will be in this world some day within the memory of those present in this room when the railways will come forward for a rate increase ---

MR. SINCLAIR: We have one standing before the Board at this moment.

MR. MAURO: Q. If the application is granted for X number of dollars, as I understand your proposal, they could go out into the transportation marketplace, they are restricted to fully distributed costs on the captive traffic, and they then have to make up the rates on the non-captive traffic, my question was: how is any deficiency in their obtaining it from the non-captive traffic made up?

A. Your question is unanswerable, because you are mixing vinegar and water. They don't come along for a general increase, they go to the Board and say, this is where our out-of-pocket costs have come up. They don't come along and ask for a general rate increase.

Q. What you are suggesting is perhaps a change in the method, because I suggest to you that under the present method of the requirements formula,

where the railways come forward for a certain sum of dollars ---

A. They need more money.

THE CHAIRMAN: Where do they get the money?

MR. MAURO: Q. Yes. They can't get the amount to bring it up. Where do they get the deficiency?

A. First of all, we assume they go to the Board and get the minima put up, so automatically they lose some traffic if it can't stand the rate. Now, I think it is partly explained in a footnote at the bottom of page 30, footnote 6. I don't know if it is necessary to read it. I think I will.

"This standard of maximum rates may be "questioned. If captive traffic is to be "carried at no more than fully distributed "costs, how can the railways carry com- "petitive traffic at less than full cost? "The question may be answered by asking "others: What would the railways do if the "captive traffic dwindled to nothing because "of increasing competition over the next "decade or so? Non-regulated competitive "businesses in other fields can manage quite "well without a corral of captive customers "to bear disproportionate overheads and "no one could reasonable expect captive "traffic -- a smaller and smaller proportion "of total freight traffic each year -- to

"carry the overhead burden for competitive "freight. As an increasing amount of non- "competitive traffic becomes subject to "competition, the railways will not be able "to rely on recovering overheads from this "source in the future. It may be pointed out "that much competitive traffic now has "rates above fully distributed cost; the "extent to which this is possible depends "on the cost level of the competitors . . . " -- and then we see that full cost for rail is 50 cents per hundred lbs., road is 55 cents per hundred lbs.;the rate for rail 55 cents per hundred lbs., road 55 cents per hundred lbs.

As you pointed out in the burden study, the traffic which is carried at less than fully distributed costs actually contributes a great deal of the overhead costs of the railways, a great deal of it. It is not necessary to have it on the non-competitive traffic over fully allocated costs.

Q. You realize, of course, in the United States they don't operate on a requirements basis.

A. Yes, I am quite aware of that.

Q. Now, I have been in agreement with everything you have said, that the captive traffic should have a limit placed on it, and I think we are here to find out what other possible solutions there are. With your solution were you faced with this problem, that if they are limited to what they can

get from the captive traffic and they then have a set number of dollars they require and they can't obtain those dollars from the non-captive traffic, where do they get it?

A. What happens in the United States in the bituminous coal is that it is carried at less than fully distributed cost, and it gets all of the burden by carrying all this bulk traffic, which is quite a lot of it. Well, they would cover a great deal of their constant cost burden. Now, you say they can't put the rates up and they make up some deficit to cover that situation, and I said to Mr. Cooper yesterday that I wasn't inflexible about it. The only thing I am really inflexible on is that the captive traffic should be related to the cost of service in some way, it should reflect it. Now, I am not absolutely inflexible on the way the maximum rate is put as long as it is reflecting in some way the out-of-pocket costs of that traffic, whether by fully distributed costs or any other way you would like to do it.

(Page 13655 follows.)

Q. As I would understand your proposed scheme, Mr. Hughes, it is in essence the present method of the Board of Transport Commissioners with a ceiling on captive traffic. The Board of Transport Commissioners will attempt to police any rates under the present tariffs that are below out-of-pocket costs that are not compensatory, and if we can bring them to the attention of the Board I am sure that some attempt will be made to bring these rates up to their proper level or have them taken out completely?

A. I would not agree it is the same as the present system, if that is what you think. I would not agree with that.

Q. What is the difference between your scheme and the present scheme in addition to the fact that you set a ceiling of fully distributed cost on captive traffic?

A. There are many differences as you read the book, but, you know, this is not what we are trying to do. One of the basis differences is the classification which has a change of loadability as the basis, and the classification runs right through the carload scale. It applies now to a very small segment. In fact, it is pretty useless.

So this is one thing. Classification gives an incentive to load while the classification today does not. We presently use also the LCL scales in classification and the carload scales in the same one, so that if there are different conditions between LCL

traffic and carload traffic, maybe a rate has to go down on the LCL. Well, the railway will not do that because the carload traffic is so closely tied in with it and we have different scales for LCL and carload. That is one difference.

Q. I was looking at paragraph 85.

A. If you want me to give you all the differences, because there are many.

Q. I was simply taking your words in paragraph 85 where you state:

"The rate making proposals put forward so far have, therefore, three essential ingredients."

The first one is:

"Minimum rates for all traffic should be no lower than long-run out-of-pocket cost."

I suggest that the principle, that rates for all traffic should be no lower than the long-run out-of-pocket costs is in fact one of the essential ingredients of the present freight rate structure in Canada. Now, it may have weaknesses, you and I know, in policing, but I suggest to you that the proposition that minimum rates should be no lower than long-run out-of-pocket costs is in fact one of the essential ingredients of our present freight rate structure?

A. I don't think so. I think there are many rates all based on short-run out-of-pocket costs. There are many suspect deficit areas which we were

talking about this morning. The minimum rates very often in the equalization scale have nothing at all to do with out-of-pocket costs of running traffic for that particular area.

Q. Are you suggesting that the present freight rate structure in Canada has a limit that it is permissive in the freight rate structure to have rates that do not return out-of-pocket costs?

A. Certainly it is permissive, otherwise I would not have had to bring in these things this morning, and passenger service is a big one.

Q. We are talking here of rate making proposals and this is the freight phase of it, and we will forget about passenger service. We are certainly in agreement on that, Mr. Hughes.

A. It is all tied in with the same one if you want to talk about that.

Q. When you talk about rate making proposals having three essential ingredients, you are not talking about passenger trains in paragraph 85, are you?

A. No, all right, but there are differences. No, we are not basing -- minimum rate is not, I think, longer than out-of-pocket costs. I said there may have been short-run out-of-pocket costs.

Q. You suggest that your scheme, that is, other than the ceiling on captive traffic, has various principles that differ from the present method utilized by the Board of Transport Commissioners in

reference to those three?

A. I am not sure of your question there.

Q. You have listed three essential ingredients to your proposals:

"Minimum rates for all traffic should be no lower than long-run out-of-pocket costs.

(b) Maximum rates should be published for captive traffic, and such rates should be no higher than fully allocated costs.

(c) Above the minima (subject to the maxima for captive traffic), recovery of overheads should be related to what the traffic will bear."

I am suggesting that outside of the limits of captive traffic to fully distributed costs, in fact the present freight rate structure permits railways to get whatever the traffic will bear on all traffic, and that the present freight rate structure sets out that the minimum level of rates should be the compensatory level or out-of-pocket?

A. Well, that gives the railways long-run out-of-pocket costs.

Q. You may be asking for further things, but I suggested to you that perhaps the present method is not being policed properly, Mr. Hughes. I thought we were talking here about essential ingredients.

A. I would say that the present freight

rate, the present way we have set things up is not at all like we have proposed. There are no advantages given for hauling traffic over a good route -- this is not reflected in the rates -- or through good terminals or anything else. I think it is very much different.

Q. Now, at paragraph 112 on page 30 there is a matter of applying to have certain traffic declared competitive.

> "The grounds for application would be that reasonable competition had been commenced for the traffic. The railways should, of course, have to show that the competition was not sporadic and that the competitive rates were rates which actually moved the traffic in some volume."

And again at paragraph 129 ---

A. Excuse me. There is in paragraph 112, I think, where it says:

> "As traffic became non-competitive --"

It should be "as traffic became competitive."

Q. Yes, thank you. In paragraph 129, (f):

> "As there is no maxima proposed for a great deal of traffic, actual rates would be left to the commercial judgment of the railways themselves as a management prerogative. Above the minima it should be entirely up to the railways what charges will be made, subject, of course, to the safeguards

against unjust discrimination."

As I see your scheme, Mr. Hughes, it would be to the railways' benefit to move to have the present non-competitive traffic competitive, because as non-competitive traffic they could only charge for the distributed costs, but if the traffic becomes competitive the sky is the limit

A. No, the sky is not the limit. The competition is the limit.

Q. All right, we will go back to what the traffic will bear. You used those words.

A. If the traffic becomes competitive it is pretty automatic that the rate is going to be less than it would be if it was captive traffic, so why should it be to the railways' advantage?

Q. Are you suggesting that present competitive rates do not return fully distributed costs and sometimes double fully distributed costs? The word "competitive", the fact that traffic is in competition, of course, does not mean it does not return fully distributed costs.

A. I was saying to you earlier, a lot of competitive traffic, this is why you do not have to load captive traffic too much with rates over the burden. There is a lot of captive competitive traffic which is carried at rates above fully allocated costs.

Your question was: well, do the railways want to get traffic out into the captive class so that

they can put rates up?

Q. Yes?

A. Well, it is really impossible to say, because the reason that the competition has come along and therefore the maximum rate has become a paper rate, so why should the railways want to do one or another? It is just to clear up the books.

Q. There are many movements in Canada today which are captive to the railways and upon which they receive more than fully distributed cost. That is what I understood was the reason for this proposal of yours, to try and protect the captive traffic against excessive charges?

A. That is taking a very wrong attitude. That is not the attitude at all. What we want is the long-run solution for the railway problem, and not for shippers. We are not looking at captive traffic and saying,"This is it for captive traffic." Otherwise we would go along with a hold-down.

Q. Mr. Hughes, I just assume that your scheme that said that the rates on captive traffic should be not permitted to rise above fully distributed cost, was based on the fact that under the present scheme, under the present method, the railways are in fact charging in excess, unfairly in excess of fully distributed cost. Otherwise why put the limitation on them?

A. Well, if you look at the United States burden study again, you see that most of this traffic

which is captive is actually having a rate which is less than fully distributed cost. So I don't know why you should think that. We may be wanting a maximum rate to go up in some cases.

Q. There is nothing stopping the railways now from increasing rates, Mr. Hughes. There is nothing stopping the railways now from increasing rates up to the class ---

MR. SINCLAIR: There sure is.

MR. MAURO: Q. Up to the permissive levels. Why put this other unnecessary regulation? If in fact what you say now is true, why make another regulation prohibiting the railways from increasing their cost or charges on captive traffic beyond fully distributed costs?

A. Because we are taking the long-term point of view, Mr. Mauro, and as we see more and more competition coming in there may be incentive, the railway may quite easily want to cut out a competitor, and there is nothing under our scheme to stop it from doing anything it wants above the out-of-pocket costs: then I think that it is quite rightly a part of railway regulation that there should be some protection for the captive shipper.

(Page 13667 follows)

Q. Well, then, for my final couple of questions, Mr. Hughes, would you turn to chapter 8, "Proposals for a New Rate Structure." Paragraph 102 on page 28 contains a carload classification table, Mr. Hughes. I would ask you to assume with me that the Class 100 rate is $1, and that the other classes represent percentages of Class 100. If that were the case then the following is the revenue per car for each weight loaded; 30,000 pounds at $1 would be $300; 40,000 pounds at $0.80 would be $320; 50,000 pounds at $0.70 would be $350; 60,000 pounds at $0.50 would be $300; and 100,000 pounds at $0.30 would be $300. Since I think it is rather obvious, Mr. Hughes, that the costs of the railway to ship 60,000 pounds or 100,000 pounds is greater than it is to move 50,000 pounds, it seems unreasonable to insist that the railways accept $50 less per car to ship 100,000 pounds than to ship 50,000 pounds.

A. Well, you know, this is an illustration for example, and I could easily put (a), (b), (c) and (d), and it would not make any difference at all. We are talking about broad proposals for a new rate structure. I am not giving actual rates in a tariff; I am giving examples of how it would look. I am not suggesting these are the rates.

Q. Let us drop the rates, but I assume your principle here is that the rates will decline from 30,000 pounds to 100,000 pounds, but you certainly do not want a declining rate schedule that would result in

less revenue for moving 100,000 pounds than for moving 50,000 pounds?

A. That is right. You cannot get the principle from looking at this. You are quite right in what you are saying.

Q. Now, paragraph 103 -- you might, perhaps, clarify this also. This is a table headed "Distance Factor", and it shows that for distances between 100 and 199 miles a rate factor of 20 cents, and a rate factor of 21 cents for a distance between 200 and 299 miles. Using the shortest distance in each block the charge for the line haul movement per ton mile for 100 miles at $4 per ton is 2.67 cents, and for 200 miles at $4.20 per ton is 1.68 cents. For the additional 100 miles of line haul the charge per ton mile is one-fifth of a cent per ton mile.

Now, what expenses are assignable to the first 100 miles which result in a ton mile rate of 2.67 cents that are not assignable to the second 100 miles?

A. I do not really know why we are dealing with figures here. This is just an illustration. I thought I would just fill in the blank places This is just an illustration; that is all.

Q. We are trying to figure out the principle involved here. I take it you want a similar rate in each rate block?

A. That is right.

COMMISSIONER MANN: Mr. Hughes, I intended

[illegible]

to ask you this sooner or later anyway, but do you make any provision for rate taper in your scheme?

A. Yes, this is in the scale where it gives distance in miles and you get your cents per 100 pounds. Well, I assume there would be a rate taper in the rate scale.

COMMISSIONER MANN: Why do you taper that rate in your scheme?

THE WITNESS: Because the costs get less per ton mile as you go further away from your terminal.

COMMISSIONER MANN: Because you go further from your terminal?

THE WITNESS: That is one reason. On long hauls you get better utilization of equipment and crews. There are many reasons for the taper.

COMMISSIONER MANN: So the line-haul factor has been taken out, so far as the taper is concerned?

THE WITNESS: Yes, but there are some other reasons for it.

COMMISSIONER MANN: Perhaps you might go into that at some time because I would like to deal with it.

MR. MAURO: Q. You are aware that under the American system the line-haul portion is a constant cost throughout the mileage block? There is no change as you get further away. The line-haul portion remains constant?

A. Yes, that may be so in the scales they

have set up.

Q. Then, there is the table headed "Arbitraries; Terminal Group and Route Group." The route group arbitrary is a flat sum added to the rate per 100 pounds, and is based on the percentage of main line movement to branch line; is that correct?

A. That is right.

Q. Thus, one shipment which moves 100 miles with 40 per cent, or 40 miles, on branch lines, has a route arbitrary of two cents added; is that right?

A. Yes, and as an example we are using cents and miles.

Q. Another shipment moving 1000 miles with 40 per cent, or 400 miles, on branch lines is also assessed only two cents as a route arbitrary?

A. Yes.

Q. This table recognizes the percentage only, and ignores the fact that the same percentage would vary directly with the length of haul?

A. Yes. Logically, you see, this route group arbitary should have been set up in cents per mile, but when you try to do that and try to incorporate it into some practical tariff I do not think too much is lost if you do it as per 100 pounds. You would lose far more if you did the terminal group like that.

Q. I was particularly interested in the route group because under this, if the shipment moves 40 miles on the branch line, there may be only a two-cent contribution, and with respect to another shipment

that moved 400 miles on the branch line, that would still only make that contribution?

A. Yes, that is so. The principles are down in writing, but we do not say that this is how we envisage it would look.

Q. It tends to favour long-haul traffic?

A. It does not matter whether it is on a mileage basis or a cent per 100 pounds basis.

MR. MAURO: Thank you very much, Mr. Hughes.

THE CHAIRMAN: We will sit tomorrow in the Convention Hall of the Chateau Laurier and you, Mr. Hume, will be next.

---Adjournment.